IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

NO. 92-1292

COLUMBIA GAS TRANSMISSION CORPORATION,
PETITIONER

V.

FEDERAL ENERGY REGULATORY COMMISSION,
RESPONDENT

ON PETITION FOR REVIEW OF ORDERS OF THE
FEDERAL ENERGY REGULATORY COMMISSION

STATEMENT OF THE ISSUES

Whether the Federal Energy Regulatory Commission (Commission) properly construed a 1985 PGA settlement agreement between Petitioner and its jurisdictional customers based on the law and policy in effect when the parties entered into the settlement and based upon evidence of the parties' intent.

PERTINENT STATUTES AND REGULATIONS

The pertinent statutes and regulations are set forth in Appendix A to this brief.

STATEMENT OF THE CASE

I. NATURE OF THE CASE, THE COURSE OF PROCEEDINGS, AND DISPOSITION BELOW

This case arises from the Commission's determination that a proposal by Columbia Gas Transmission Corporation (Columbia) to impose a surcharge on natural gas it sells to its customers was not authorized by a 1985 settlement between Columbia and its customers. Columbia Gas Transmission Corp., "Order Rejecting

Tariff Sheets," 56 FERC ¶ 61,340 (August 30, 1991), R. 210-216, J.A. 76-82; Columbia Gas Transmission Corp., "Order on Rehearing," 59 FERC ¶ 61,233 (May 22, 1992), R. 239-247; J.A. 103-11.

II. STATEMENT OF THE FACTS

A. Background: Columbia's 1985 PGA Settlement

On April 4, 1985, Columbia filed with the Commission a proposed settlement of a number of Columbia Purchased Gas Adjustment (PGA) proceedings 1/ in which Columbia's customers had protested that Columbia's purchasing practices were imprudent and abusive. Article IV of that settlement prohibited Columbia from collecting from its customers any unrecovered purchased gas costs (except pipeline supplier demand costs) for the period April 7, 1985 through March 31, 1987 (the "settlement period"). In addition, it barred Columbia from recovering any previously unrecouped purchased gas costs that had accrued prior to the settlement period, with one exception: Article IV authorized Columbia to recover up to $600 million of unrecouped purchased gas costs relating to the pre-settlement period, through a commodity rate surcharge during a seven-year period commencing

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1/ Commission regulations in effect in 1985, see 18 C.F.R. § 154.38(d), authorized pipelines to file a purchased gas adjustment (PGA) every six months to reflect: 1) a current gas cost adjustment that would constitute a charge designed to collect any variance between the pipeline's projected gas costs and its effective base rate for the succeeding six-month period; and 2) a surcharge to recoup or refund its Account No. 191 balance, which represented the difference between the actual gas cost and the projected gas cost for the preceding six month period.

September 1, 1987, only if Columbia met a "WACOG" test established in Appendix F of the settlement. In relevant part, Appendix F provided

> with respect to the unrecovered costs experienced by Columbia as described in and subject to the limitations as set forth in Article IV hereof, commencing September 1, 1987, Columbia shall be permitted to commence the recovery of such costs provided it satisfies the following test: During each year of the seven-year recovery period, Columbia's weighted average cost of gas ("WACOG") during the twelve months ended the preceding December 31 shall be compared with the WACOG of its five major pipeline suppliers [2/] for the same period, using the FERC Form No. 2 filings of the respective companies. To the extent each year that Columbia's WACOG minus $.22 per Mcf ("adjusted WACOG") is less than the WACOG of its five major pipeline suppliers ("differential"), Columbia may apply a twelve-month surcharge to its commodity sales rate for one-half of the differential.

Appendix F of the PGA settlement also provided that Columbia would calculate its WACOG and that of its five pipeline suppliers in the format used in Table 1 of that Appendix. Table 1, in turn, provided for determining Columbia's and its upstream suppliers' WACOG in exactly the same manner, i.e., by dividing their "cost of gas in dollars" by the sum of their gas purchase volumes. Table 1 went on to provide that the "cost of gas in dollars" and "sum of gas purchase volumes" shall be the amounts

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2/ These upstream suppliers were: Panhandle Eastern Pipe Line Company, Texas Eastern Transmission Corporation, Texas Gas Transmission Corporation, Tennessee Gas Pipeline Company, and Transcontinental Gas Pipe Line Corporation.

reported for Account Nos. 800-805 (excluding Account Nos. 805.1 and 805.2) of each pipeline's annual FERC Form No.2 report.

B. Supervening Regulatory Changes That Altered Columbia's Accounting Treatment Of Take-or-Pay Settlement Payments To Upstream Pipeline Suppliers

Following the conclusion of the 1985 settlement, two regulatory changes occurred which altered Columbia's accounting treatment of take-or-pay costs, and which, in turn, ultimately affected Columbia's calculation of the WACOG test. The first regulatory change occurred in the wake of this Court's June 1987 decision in Associated Gas Distributors v. FERC, 824 F.2d 981 (D.C. Cir. 1987)("AGD I"), which remanded the Commission's open-access rulemaking in Order No. 436 3/ and directed the Commission to consider solutions to pipelines' take-or-pay liability as affected by that rulemaking.

On August 7, 1987, the Commission responded to the remand in AGD I by issuing Order No. 500, an interim rule that established a policy authorizing pipelines which had agreed to absorb a percentage of take-or-pay settlement costs to recover an equal percentage of those costs by means of a fixed charge (also referred to as a "direct bill") from their downstream customers

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3/ Order No. 436, 50 Fed. Reg. 42408 (1985), [1982-1985] FERC Stats. & Regs., Regulations Preambles ¶ 30,665, reh'g granted in part, Order No. 436-A, 50 Fed. Reg. 52217 (1985), [1982-1985] FERC Stats. & Regs., Regulations Preambles ¶ ¶ 30,675, reh'g denied, Order No. 436-C, 51 Fed. Reg. 11566 (1986), 34 FERC ¶ 61,404, reh'g denied, Order No. 436-D, 51 Fed. Reg. 11569 (1986), reversed in part and remanded, Associated Gas Distributors v. FERC, 824 F.2d 981 (D.C. Cir. 1987), cert. denied sub nom., Southern California Gas Co. v. FERC, 108 S.Ct. 1468 (1988).

(including pipelines) based on a "purchase deficiency allocation method." 4/ Downstream pipeline customers (such as Columbia), in turn, were required to recover those costs from their own customers "as billed" by their upstream pipelines suppliers, i.e., by means of their own direct bills based on the downstream customers' purchase deficiencies. 18 C.F.R. § 2.104(c),(e).

The second regulatory change, which is crucial to the issue presented here, occurred in April 1989, when the Commission's Office of the Chief Accountant changed the accounting treatment for lump-sum take-or-pay payments. In a letter issued on October 17, 1988, as confirmed by a statement to a group of pipeline industry representatives in April 1989, the Commission's Chief Accountant explained that all Order No. 500 take-or-pay fixed charges billed to downstream pipelines by upstream pipelines should be accounted for on the downstream pipeline's books in Account No. 803. 5/

4/ Under the purchase deficiency allocation methodology, each downstream customer's fixed charge was based on its deficiency of purchases during a past base period.

5/ This announcement was unprecedented in the sense that until the Chief Accountant made this pronouncement, Account No. 803 had been utilized exclusively for recording commodity and demand charges (including minimum bills) for gas purchased from upstream pipeline suppliers recoverable through PGA tariff filings, and take-or-pay settlement charges had been specifically excluded from this account. See Tennessee Gas Pipeline Company, 31 FERC ¶ 61,052, at p. 61,100 (April 16, 1985).

This April 1989 staff pronouncement to the industry established that Account No. 803 would thereafter include both purchased gas costs and non-gas costs (i.e., Order No. 500 take-or-pay costs) for accounting purposes only. For (continued...)

Once the Chief Accountant made this announcement in April 1989, Columbia immediately modified its internal accounting procedures for pipeline supplier Order No. 500 costs flowed through to it "by making its charges to Account 803 instead of 813," where it previously had recorded all Order No. 500 take-or-pay settlement costs. R. 192, 196, J.A. 68, 72. Furthermore, although Columbia had uniformly recorded its upstream suppliers' Order No. 500 charges in its Account No. 813 through the end of March 1989, it retroactively changed its accounting records for 1988, by making a "post-closing journal entry" that adjusted its Form No. 2 report for 1988 (which had not been filed with the Commission). R. 196, J.A. 72. Thus, Columbia's 1988 Form No. 2 report, as ultimately filed with the Commission, reflected all upstream supplier/Order No. 500 charges in Account No. 803. See R. 196, J.A. 72.

Columbia's flowthrough of Order No. 500 fixed charges based on the purchase deficiency method continued until at least December 1989, when this Court invalidated the purchase deficiency method under the filed rate doctrine. See Associated Gas Distributors v. FERC, 893 F.2d 349, 354-57 (D.C. Cir. 1989), cert. denied, 111 S.Ct. 277 (1990)("AGD II"). During 1990, Columbia estimated that, as a result of prevailing in AGD II, it would at some later date receive refunds of approximately $165

5/(...continued)
rate purposes, only the purchased gas cost entries in this account were employed in calculating a downstream pipeline's WACOG as reflected in its PGA filings.

million from its upstream pipeline suppliers based on prior purchase-deficiency-based overpayments of upstream supplier/Order No. 500 fixed charges. 6/ Columbia recorded these estimated "credits" in Account No. 803 for the purposes of the 1990 Form No. 2 report that it filed with the Commission during 1991.

C. Columbia's Tariff Filing In This Case

On August 1, 1991, Columbia filed tariff sheets with the Commission to implement a 20-cent per decatherm (Dth) 7/ surcharge on the natural gas it sells to its customers to begin on September 1, 1991. R. 1-4, 13-21, J.A. 1-13. Columbia claimed that this proposed surcharge was authorized by Article IV of the 1985 PGA settlement, described supra, p. 2-3.

Columbia asserted that, based on its 1990 FERC Form No. 2 report filed with the Commission, its 1990 WACOG was $1.98 per Dth of gas while the combined WACOG for its five pipeline suppliers was $2.37 per Dth. R. 2, J.A. 2. Columbia explained that, once the $.22 per Dth allowance from Appendix F was

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6/ As a result of the Court's decision in AGD II, supra, the Commission issued Order No. 528, Mechanism for Passthrough of Pipeline Take-or-Pay Buyout and Buydown Costs 53 FERC ¶ 61,163 (1990), reh'g in part, 54 FERC ¶ 61,095, reh'g denied, 55 FERC ¶ 61,372. That order required Columbia's upstream pipeline suppliers (except Transco) to reallocate their take-or-pay charges. While, by the end of 1990, only one upstream pipeline had made a filing under Order No. 528 and no refunds had actually been passed through to Columbia, Columbia estimated that these credits would amount to $165 million.

7/ A decatherm is a measurement of the heating value of gas. It has a volumetric equivalent of one Mcf, i.e., one-thousand cubic feet of natural gas, with a a heating value of one-thousand BTU per cubic foot.

subtracted from its \$ 1.98 WACOG, the resultant \$ 1.76 "adjusted" WACOG created a \$.61 per Dth differential between its WACOG and that of its five pipeline suppliers. On that basis, Columbia claimed that it was entitled to institute a surcharge of one-half of that amount, or \$.30 per Dth on its customers' bills. Id. Due, however, to "current competitive conditions," Columbia proposed a reduced surcharge of \$.20 per Dth. R. 2, J.A. 2.

A number of Columbia's customers filed protests and motions to reject Columbia's surcharge arguing that the WACOG test established in the 1985 PGA settlement was only intended to measure Columbia's current cost of purchased gas, that take-or-pay costs were never considered a cost of "purchased gas," and that a reduction in take-or-pay costs was therefore not properly included in calculating Columbia's current cost of purchased gas. R. 51, J.A. 16; R. 73-75, J.A. 20-22; R. 111-115, J.A. 25-29; R. 128-130, J.A. 39-41; R. 135-138, J.A. 46-49; R. 150-153, J.A. 52-55; R. 177-78, J.A. 59-60. Specifically, the customers challenged Columbia's inclusion of these Order No. 500-related credits in Account No. 803, one of the Accounts designated in Table 1 of Appendix F to serve as a basis for the WACOG test.

D. The Commission's Order Rejecting Columbia's Filing

On August 30, 1991, the Commission issued an order in which it rejected Columbia's proposed surcharge. R. 210-17, J.A. 76-83. At the outset, the Commission noted, R. 214, J.A. 80, that the basis for the \$165 million figure in Columbia's filing was unclear, insofar as it was based on estimates rather than actual credits received from pipeline suppliers.

In any event, the Commission concluded that Columbia's inclusion of the $165 million as a credit in its calculation of the Account No. 803 balance for purposes of the WACOG test "did not seem to be consistent with the 1985 PGA settlement." R. 214, J.A. 80. The Commission explained that it had previously determined in its April 1985 policy statement that take-or-pay costs are not purchased gas costs, R. 215, J.A. 81, and that the "same rationale" also required that take-or-pay refunds should not be considered as refunds of purchased gas costs for the purposes of the 1985 PGA settlement. R.215, J.A. 81. 8/

Finally, the Commission observed that without this $165 million credit Columbia's 1990 WACOG was approximately $2.63 per Mcf. Because this amount exceeded the WACOG of its pipeline suppliers by more than $.22 per Dth, the Commission concluded that Columbia failed to satisfy the WACOG test as established in the 1985 settlement, and therefore Columbia was contractually barred from instituting its proposed commodity surcharge. R. 215, J.A. 81.

8/ Inasmuch as the Commission found that the settlement itself precluded using take-or-pay credits in calculating Columbia's WACOG, it found it unnecessary to address the accounting issue as to whether the $165 million was properly included in Account No. 803. R. 214 n.6 ; J.A. 80 n.6.

E. <u>The Commissions' Order On Rehearing</u>

On May 22, 1992, the Commission issued an order denying rehearing in which it reaffirmed its conclusion that the 1985 settlement "did not contemplate that take-or-pay charges and/or refunds from Columbia's upstream suppliers be included in Columbia's WACOG calculation." R. 242, J.A. 106. The Commission, however, based its conclusion on a different rationale from that adopted in its earlier order.

While the Commission agreed with Columbia that "purely as an accounting matter, fixed take-or-pay charges billed to a downstream pipeline should be accounted for in Account No. 803," it nevertheless found that it was improper for Columbia to include those charges (or reductions thereof) in its WACOG calculation. R. 243-44, J.A. 107-08.

The Commission explained that it had determined in 1985 that for accounting purposes, one-time, nonrecoupable take-or-pay settlement payments were not to be accounted for as gas costs. In fact, the Commission noted, while Columbia's settlement was still pending, it had ruled in another Columbia proceeding that one-time take-or-pay payments should not be recorded in Account No. 803, but instead should be included in Account No. 813. R. 244, J.A. 108, citing <u>Columbia Gas Transmission Corp.</u> v. <u>Tennessee Gas Pipeline Co.</u>, 31 FERC ¶ 61,053 (1985). <u>9/</u>

<u>9/</u> The Commission also pointed out that even before the 1985 PGA settlement was approved, it had consistently held that "take-or-pay costs are not purchased gas costs for rate purposes." R. 245, J.A. 109, citing Policy Statement,
(continued...)

The Commission went on to explain that it was not until the Commission's Chief Accountant announced the accounting policy change, under which fixed take-or-pay charges billed to downstream pipelines pursuant to Order No. 500 should be included in Account No. 803, that Columbia began to account for the take-or-pay charges in this manner by including them in Account No. 803. In conclusion, the Commission found

> [b]ased on Columbia's own accounting practices and Commission orders at the time of the settlement, both the Commission and all parties including Columbia, must have negotiated, approved and accepted the settlement on the basis that upstream supplier take-or-pay costs of the type here at issue would not be included in the WACOG calculation.

R. 244-45, J.A. 108-09.

The Commission further found that this interpretation of the WACOG test of Appendix F of the 1985 PGA settlement was consistent with the overall purposes of the settlement. R. 245, J.A. 109. The Commission explained that the 1985 settlement was designed to settle a number of contested PGA cases filed by Columbia and that the Commission had "historically" used the term WACOG to refer only to costs recoverable through the PGA, which did not include lump-sum take-or-pay payments. Moreover, the Commission observed that--both before and after the settlement, it had "consistently held that take-or-pay costs are not gas

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9/ (...continued)
"Regulatory Treatment Of Payments In Lieu Of Take-or-Pay Obligations'" [1982-1985] FERC Stats & Regs., Regulations Preambles ¶ 30,637 (April 1985).

costs for purposes of rate-making, regardless of the appropriate accounting treatment for those costs." R. 245, J.A. 109.

In addition, the Commission explained that "the entire focus" of the dockets settled under the 1985 agreement was on gas costs thereafter to be included in Columbia's PGA, and that the "obvious intent" of the parties in formulating the 1985 settlement was to give Columbia an "incentive to bring its high cost of gas as reflected in its PGA closer in line with the lower cost of gas reflected in the PGAs of its pipeline competitors." R. 245-46, J.A. 109-110. The Commission stated that to include the take-or-pay credits in Columbia's WACOG calculation would defeat this goal. R. 246, J.A. 110.

In this vein, the Commission further noted that the purported $ 165 million in refunds are only Columbia's estimates of the refunds it would receive from its upstream suppliers, and in fact, during 1990, no refunds had been received by Columbia. Thus, the Commission concluded "the take-or-pay refunds are not related to actual gas costs in the year in question." R. 246, J.A. 110.

Finally, responding to Columbia's assertion that the estimated credit was allowable under a literal interpretation of the WACOG test in the 1985 PGA settlement--because the Commission's current accounting practices called for including take-or-pay charges in Account No. 803--the Commission stated:

> the issue raised by Columbia on rehearing ultimately turns on whether we should apply present Commission accounting requirements as to the use of Account No. 803, or do what all

> parties expected at the time and exclude upstream pipeline take-or-pay costs or credits from Columbia's WACOG calculations. We hold that the settlement should be interpreted in light of the understanding of the Commission and expectation and intent of the parties at the time the settlement was entered into. To allow Columbia to include the take-or-pay credits in its WACOG calculation would be contrary to the intent of the Commission and the parties to Columbia's 1985 settlement when the settlement was approved.

R. 246-47, J.A. 110-11.

This appeal followed.

SUMMARY OF ARGUMENT

I.

A. This Court should defer to the Commission's reasonable interpretation of ambiguous contractual provisions. Here an ambiguity arises from the 1985 PGA settlement because it relied on an accounting methodology that at the time of the settlement did not include one-time, nonrecoupable take-or-pay settlement costs.

B. It is well settled that where a mutual understanding is displaced by a new government regulation, the original intent of the parties' controls the interpretation of a contract. E.g. Alvin Ltd. v. U.S. Postal Service, 816 F.2d 1562, 1565-1567 (Fed. Cir. 1987). Because the accounting law as it existed in June 1985 formed the basis for the parties' mutual understanding, the Commission was entitled to look to the law in effect in 1985 and manifestations of the parties' intent at that time.

C. Based on the law as it existed in 1985 and the underlying purposes of the 1985 settlement, the Commission properly concluded that the parties did not envision inclusion of take-or-pay credits to calculate Columbia's WACOG.

1. At time of the 1985 settlement, the Commission had declared that lump-sum payments in satisfaction of take-or-pay liabilities must be recorded in Account No. 813. This accounting treatment persisted until April 1989, when the Chief Accountant formally announced that downstream pipelines should account for such costs in Account No. 803, i.e., one of the

Accounts designated by the WACOG test in Appendix F of the 1985 settlement. In these circumstances, the Commission properly attributed great weight to the fact that the new type of accounting treatment that Columbia seeks to apply here was not permissible when it entered into the 1985 settlement.

2. The Commission also reasonably concluded that since the purpose of the WACOG was to give Columbia an incentive to bring its high gas costs into line with the lower purchased gas costs of its upstream pipeline suppliers, the "obvious intent" of the parties to the 1985 settlement was to exclude lump-sum take-or-pay credits from the WACOG test calculations.

In addition, as the Commission further observed, the WACOG test implies consistent accounting treatment between Columbia and its upstream suppliers. Because Columbia's upstream suppliers recorded in Account No. 813 the same take-or-pay fixed charges that Columbia after April 1989 recorded in Account No. 803, consistency requires that Columbia exclude the Order No. 500 credits from Account No. 803 for the purposes of measuring the WACOGs of Columbia and its upstream suppliers.

II.

The Commission also properly rejected Columbia's tariff filing without suspending it and setting it for hearing on the ground that it violated the 1985 PGA settlement. It is well-established that under the Mobile-Sierra doctrine the Commission may so reject a utility's filing to increase its rates on the ground the increase is barred by a contract.

Nor has petitioner established any basis for convening a formal evidentiary hearing. Petitioner failed to raise an issue of material fact or even to make a proffer of evidence suggesting that the parties agreed to be bound by unforeseen regulatory changes.

ARGUMENT

I. The Commission Reasonably Concluded That Columbia's Proposed Surcharge Was Barred By The 1985 PGA Settlement.

Columbia chiefly argues that the 1985 settlement is "unambiguous" and that, according to the settlement's express terms, it was entitled to use its Order No. 500 credits to compute its WACOG. As we proceed to explain, however, the Commission's 1989 change in its accounting rules shows that the meaning of the 1985 settlement was ambiguous. Moreover, we submit that the Commission reasonably interpreted the settlement's ambiguous provisions at issue here based on well-established principles of contract construction and evidence of the intent of the parties.

A. The Commission's Construction Of The Ambiguous Terms Of An Agreement, If Reasonable, Is Entitled To Deference.

1. In National Fuel Gas Supply Corp. v. FERC, 811 F.2d 1563, 1569 (D.C. Cir. 1987), cert. denied, 484 U.S. 869 (1987), this Court ruled that, unless the meaning of the terms of a settlement agreement is clear and unambiguous, a reviewing court is required "to give deference to an agency's reading of a settlement agreement even where the issue simply involves the proper construction of language." In this Court's view, id. at 1569-70, that result follows from the Supreme Court's decision in Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 843 n.11 (1984), that an agency's construction of statutory provisions it is responsible for administering must be

adopted so long as the interpretation is permissible, even if it is not "the reading the court would have reached if the question initially had arisen in a judicial proceeding."

This Court further explained in National Fuel that this rule of deference is rooted in the Commission's special expertise to construe agreements on file with it "where the understanding of the documents involved is enhanced by technical knowledge of industry conditions and practices." 811 F.2d at 1570-71, quoting Columbia Gas Transmission Corp. v. FPC, 530 F.2d 1056, 1059 (D.C. Cir. 1976). It also observed that the rule "ensure[s] that the Commission is established as the primary adjudicator in this field, as Congress intended." National Fuel, 811 F.2d at 1571; see also Tarpon Transmission Co. v. FERC, 860 F.2d 439, 441-42 (D.C. Cir. 1988).

More recently, in Cajun Electric Power Cooperative, Inc. v. FERC, 924 F.2d 1132, 1135 (D.C. Cir. 1991) ("Cajun"), this Court noted that this deference principle is particularly appropriate where the agency has approved an agreement, thus making it more closely akin to an order of the Commission than to an agreement between private parties. According to this Court, "when the agency reconciles ambiguity in such a contract it is expected to do so by drawing upon its view of the public interest," and therefore is entitled to just as much benefit of the doubt "as it would in interpreting its own orders, . . . its regulations . . . , or its authorizing statute." Id.

Under these principles the Commission's orders should be upheld.

B. **<u>It Is Well-Settled That Where A Contract Incorporates A Policy Or Regulation That Has Subsequently Been Changed, An Ambiguity Arises That Should Be Resolved In Light Of The Law In Effect At The Time The Agreement Was Concluded And The Intent Of The Parties</u>**

As Columbia correctly states in its brief (Pet. Br. 15), the Commission found that the WACOG test of the 1985 settlement was ambiguous. Contrary to Columbia's view, however, the Commission's conclusion in this regard was well-founded. As we have explained, <u>supra</u>, the WACOG test set forth in Appendix F of the settlement states that the "cost of gas" shall be the amount reported in Account No. 803. In 1985, Account No. 803 was restricted to costs recoverable through a pipeline's PGA, and therefore did not include one-time (<u>i.e.</u>, lump sum), nonrecoupable take-or-pay settlement payments. In 1989, however, the Commission's Chief Accountant reversed this rule, stating that Account No. 803 should be used by downstream pipelines to record lump-sum Order No. 500 take-or-pay costs flowed through to them by their upstream pipeline suppliers. The upshot was that by the time this case came before the Commission take-or-pay costs like those at issue here were included in Account No. 803 for downstream pipelines, but not upstream pipelines. In these circumstances, the Commission properly treated the 1985 settlement as ambiguous and gave weight to the law as it existed in 1985 and the manifestations of the parties' intent in order to construe the settlement.

It is, of course, well settled that:

> the laws which subsist at the time and place of the making of a contract, and where it is to be performed, enter into and form a part of it, as if they were expressly referred to or incorporated in its terms. The principle embraces alike those which affect its validity, construction, discharge, and enforcement.

Von Hoffman v. City of Quincy, Mass., 71 U.S. (4 Wall) 535, (1866)(emphasis added). "Contracting parties are not required to foresee changes in the governing law." Vollmar v. CSX Transportation, Inc., 705 F.Supp. 1154, 1175 (E.D. Va. 1989), construing New York Central & Hudson River R. Co. v. Gray, 239 U.S. 583, 586-87 (1916) ("Gray"). As the Federal Circuit has recognized:

> In resolving a disputed interpretation of a contract, words and other conduct are interpreted in light of all the circumstances, and if the principal purpose of the parties is ascertained, it is given great weight.

Alvin, Ltd. v. U.S. Postal Service, 816 F.2d 1562, 1565 (Fed. Cir. 1987)("Alvin"), quoting Restatement (Second) of Contracts, § 202(1). Moreover, as the Alvin court also observed, when a mutual understanding is displaced by an intervening government regulation, the original intent of the parties is controlling "even where the contractual term is defined differently by statute or administrative regulation." 816 F.2d at 1567, quoting Restatement (Second) of Contracts, § 201, comment c; see also Gray, 239 U.S. at 586-87.

Since the unanticipated change in accounting policy, and the unforeseen changes in cost recovery methodology caused by Order No. 500, created an ambiguity about the parties' intent in this case, it was appropriate for the Commission to look to extrinsic evidence such as the law in effect in 1985 and manifestations of the intentions of the parties at that time. See, e.g., Alvin, 816 F.2d at 1565-67 (Fed. Cir. 1987); Gray, 239 U.S. 586-87. As the Commission explained, these factors do not support petitioner's interpretation of the 1985 settlement.

C. The Commission Reasonably Concluded That The 1985 PGA Settlement Did Not Envision The Inclusion Of Take-or-Pay Credits In Calculating Columbia's WACOG.

1. In 1985, And For Several Years Thereafter, Lump-Sum Take-or-Pay Costs Could Not Be Included In Account No. 803.

Contrary to the claim of petitioner, at the time of the 1985 PGA settlement, which was executed before Order No. 436 and long before AGD I, neither Columbia nor its customers had any notion that the Commission would someday authorize Columbia to recover take-or-pay costs in lump-sum direct bills through an account--Account No. 803--that, at least from early 1985 through April 1989, was restricted to costs recoverable through Columbia's PGA, and excluded one-time nonrecoupable take-or pay payments.

At the time the Commission approved Columbia's PGA settlement--June 1985--the parties only had notice that lump-sum "one-time nonrecoupable payments" to producer-suppliers to settle take-or-pay liabilities had to be recorded in Account No. 813, not Account No. 803, and could not be recovered from downstream customers on a lump-sum, direct bill basis.

One of the first cases that addressed the accounting treatment of the take-or-pay settlement costs was Columbia Gas Transmission Corporation v. Tennessee Gas Pipeline Company, 29 FERC ¶ 61,203 (1984), reh'g denied, 31 FERC ¶ 61,053 (1985). In that case, Columbia's upstream pipeline supplier, Tennessee Gas Pipeline Company ("Tennessee"), applied to the Commission for approval of a settlement agreement which would reduce Columbia's liability for past minimum bills, in exchange for the Columbia's agreement to make one-time, nonrecoupable payments directly to Tennessee's producer-suppliers to settle Tennessee's take-or-pay liability to those suppliers. Under the settlement proposal, Columbia sought approval to account for these nonrecoupable payments as "gas costs," recoverable through its PGA filings.

The Commission rejected Columbia's PGA recovery proposal on the ground that it did not consider such take-or-pay settlement costs to be "gas costs" and further ruled that one-time (i.e., lump-sum) take-or-pay settlement payments made by Columbia must be charged to Account No. 813, not Account No. 803, as Columbia had proposed:

> We emphasize that one-time, non-recoupable take-or-pay payments are not "gas costs" to be charged to Account Nos. 800 through 803 of the Uniform System of Accounts, but they are the type of expenses to be charged to Account No. 813 (Other gas supply expenses).

31 FERC at 61,105 n.14 (emphasis added); see also 31 FERC at 61,103-04. 10/

This approach was confirmed in a Commission policy statement issued the same month this case was decided, April 1985, announcing that non-recoupable payments in take-or-pay settlements were not "purchased gas costs" within the meaning of its PGA regulations, 18 C.F.R. § 154.38(d)(4), and therefore were not recoverable through a pipeline's PGA, but may be recovered by pipelines only through their commodity rates. 11/ Regulatory Treatment of Payments Made In Lieu Of Take-or-Pay Obligations, Regulations Preambles, FERC Stats. & Regs. ¶ 30,637 (April 10, 1985), at pp. 31,299-300 (the "April 1985 Policy Statement").

10/ In another April 1985 order, the Commission made it unmistakably clear that take-or-pay settlement payments may not be charged to PGA Account Nos. 800 through 803 of the Commission's Uniform System of Accounts, 18 C.F.R. §§ 201.801-03 (1985), by squarely rejecting a claim by Tennessee that take-or-pay settlement payments to producers should be charged to those accounts. Tennessee Gas Pipeline Company, 31 FERC ¶ 61,052 (April 16, 1985).

11/ By allowing recovery only on a "per-sales unit" basis through commodity rates, the April 1985 policy statement prohibited pipelines from recovering these lump-sum payments on a lump-sum, direct-bill basis. As previously noted, this policy lasted until August 1987 when the Commission issued Order No. 500 in response to AGD I.

The April 1985 policy statement also expressed the Commission's view that nonrecoupable payments to producers in settlement of take-or-pay obligations do not constitute the payment of a "price" for "gas". Id.

The Commission adhered to these views throughout the period predating Order No. 500. 12/

This "commodity rate-only" cost recovery policy that existed since April 1985 was significantly altered in August 1987 when the Commission issued Order No. 500, and for the first time allowed pipelines to recover take-or-pay costs on a lump-sum, direct-bill basis. In 1988, the Commission declared in an unrelated case that the new direct bill recovery scheme established by Order No. 500 was not foreseen by the parties when they entered into the 1985 settlement. Thus, in Columbia Gas Transmission Corporation, 45 FERC ¶ 61,144 (1988), the Commission rejected Columbia's customers' claim that Article IV of the 1985 PGA settlement, the same provision at issue here, barred Columbia's recovery of Order No. 500 take-or-pay buyout costs of upstream pipeline's billed to Columbia, 13/ stating:

> The costs to be recovered here are not Columbia's take-or-pay payments to producers, but take-or-pay buyout costs of upstream pipelines billed to Columbia pursuant to "fixed take-or-pay charges" under Order No.

12/ In March 1987, shortly before AGD I and Order No. 500 issued, the Commission denied Columbia's request to flow take-or-pay settlement payments to producers through its PGA. See Columbia Gas Transmission Corporation, 38 FERC ¶ 61,319 (1987).

13/ Columbia's customers had claimed that the 1985 PGA settlement barred Columbia from recovering Order No. 500 costs because, they alleged, those costs related to take-or-pay liability that had accrued during the settlement period, a period when Columbia was contractually barred from recovering such costs. The Commission found that these costs were "current costs," not relating to the settlement period, and thus were eligible for Order No. 500 recovery by Columbia. 45 FERC at 61,433-34.

> 500 . . . . In 1985, when the parties entered into the Settlement Agreement, they could not have contemplated that the Commission would in Order No. 500 authorize pipelines to recover take-or-pay settlement costs through "fixed take-or-pay charges" which, strictly speaking, do not constitute either demand or commodity charges. Accordingly, the Settlement Agreement does not specifically address Columbia's right to recover such fixed take-or-pay charges billed by upstream pipelines.

Id. at 61,433-34 (emphasis added).

While Order No. 500 materially changed the way pipelines could recover take-or-pay charges, i.e., from a commodity rate recovery to an alternative lump-sum, direct bill recovery scheme, it did not alter the 1985 Commission precedent holding that "one-time nonrecoupable payments," i.e., lump-sum payments, in satisfaction of take-or-pay liabilities must be recorded in Account No. 813, not Account No. 803. 14/ Columbia has

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14/ Columbia contends (Pet. Br. 21-22) that since the April 1985 policy statement provided for recovery of one-time, nonrecoupable take-or-pay payments through an upstream pipelines' commodity rates, the parties' expectation in 1985 would have been that downstream pipelines would recover these commodity charge payments through Account No. 803 and their PGAs. But this case has nothing to do with recovery of take-or-pay costs through commodity charges. The credits at issue in this case relate solely to refunds due Columbia for prior overpayments of lump-sum, direct bills, the very type of "one-time, nonrefundable payments" that the Commission ruled in 1985 must be recorded in Account No. 813, and could not be recovered through the PGA.

Because of Order No. 500's "as-billed" requirement, Columbia was prohibited from recovering these lump-sum, direct bills through its PGA or commodity rates. Instead, it was required to pass these direct bills onward to its customers as fixed, "demand-type" charges. The April 1985 policy statement did not apply to direct bill recoveries. Thus, the parties in 1985 would not have had any reason to expect

(continued...)

admitted that, at least until April 1989, it relied on the Commission's precedent 15/ requiring pipelines to book lump-sum take-or-pay settlement payments to producers in Account No. 813 as the controlling accounting methodology for Order No. 500 costs billed to downstream pipelines like itself:

> [b]ased on the Commission's holdings regarding the proper accounting treatment for Order No. 500 costs incurred from producers, Columbia initially charged its estimate of the liability for upstream pipeline Order 500 costs to Account 813. This accounting treatment lasted through March 1989 business. In April 1989 . . . the Office of the Chief Accountant clearly stated that, in its opinion, the Order 500 costs of upstream pipelines should be charges to Account 803 of downstream pipelines. As a result of this discussion, Columbia Transmission modified its accounting for pipeline Order 500 Fixed Charges by making its charges to Account 803 instead of Account 813.

R. 196, J.A. 72. (Emphasis added.)

In these circumstances, the Commission properly gave great weight to the fact that the type of accounting treatment petitioner seeks here was not allowed when it entered into the

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14/ (...continued) that the accounting policy applicable to commodity charge recovery under the April 1985 policy statement (e.g., through Account No. 803 and the PGA) would apply to a direct-bill recovery scheme, such as was ultimately authorized by Order No. 500.

15/ See Tennessee Gas Pipeline Company, 31 FERC ¶ 61,052 (April 16, 1985); Columbia Gas Transmission Corporation v. Tennessee Gas Pipeline Company, 29 FERC ¶ 61,203 (1984), reh'g denied, 31 FERC ¶ 61,053 (1985); Columbia Gas Transmission Corporation, 38 FERC ¶ 61,319 (1987).

1985 settlement, and thus could not have been anticipated by the parties to that settlement. 16/

2. <u>**Other Evidence Relied Upon By The Commission Also Supports Its View That The Parties Did Not Intend To Allow Columbia To Include Lump-Sum Take-or-Pay Payments In Account No. 803.**</u>

Nor is petitioner's construction of the agreement warranted by any other evidence of the parties' intent. In the orders under review, the Commission found that the "obvious intent" of the parties to the 1985 settlement was "to give Columbia an incentive to bring its high cost of gas as reflected in its PGA closer in line with the lower cost of gas as reflected in the PGAs of its pipeline competitors." 59 FERC at p. 61,794. The Commission further reasoned that:

> to allow Columbia to include the take-or-pay credit in its WACOG calculation would defeat this goal, since it would lead to a substantial distortion in the WACOG calculation resulting in that calculation not reflecting the actual gas costs incurred by Columbia during calendar year 1990.

<u>Id.</u> Thus, according to the Commission, the WACOG test of the 1985 PGA settlement was never intended to dilute Columbia's incentive to reduce the costs of gas actually purchased by allowing Columbia to take an offsetting credit for charges over which it had no control 17/ against the actual costs of its

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16/ Columbia concedes (Pet. Br. 23) that "there is no reason for the parties to have contemplated the manner in which Columbia should account for such unanticipated [Order No. 500] charges."

17/ In <u>Columbia Gas Transmission Corporation</u>, 45 FERC ¶ 61,144 (1988), discussed <u>supra</u>, the Commission analogized Order No. (continued...)

purchases of gas--costs over which Columbia can exert some control by varying its purchasing practices among its five competing pipeline suppliers, and by purchasing from the spot market. 18/

Moreover, the Commission's finding that the intent of the parties was that Columbia would bring its purchased gas costs into line with the lower gas costs of its upstream pipeline suppliers, R. 245-46, J.A. 109-110; 59 FERC at. p.61,794, necessarily implies a consistency between the way Columbia computes its WACOG, and the way Columbia calculates the WACOG for its five upstream suppliers. At least until Columbia changed its accounting treatment for Order No. 500 costs in April 1989, both Columbia and its upstream suppliers accounted for the same Order No. 500 costs consistently--in their respective Accounts No. 813-

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17/ (...continued) 500 costs as akin to "pipeline supplier demand charges . . . which Columbia must pay regardless of the amount of gas it actually purchases from the upstream supplier." The Commission referred to these as "charges over which it [Columbia] essentially has no control." Id.

18/ Petitioner concedes (Pet. Br. 30) that in negotiating the 1985 settlement, "[t]he parties were concerned with Columbia's overall commodity rate." See also Columbia Gas Transmission Corp., 31 FERC ¶ 61,306 at 61,678(1985) (Article IV is part of 1985 PGA settlement which "provides Columbia strong incentives to take actions to further reduce its commodity rate"). Yet, the credits at issue here related solely to lump-sum, direct bills authorized by Order No. 500, which were never reflected in Columbia's commodity rates. Moreover, once Columbia actually receives the refunds, they will not be reflected as reductions to Columbia's commodity rates; instead, they will be distributed according to Columbia's Order No. 528 filings.

-thus allowing a clear comparison of purchased gas costs as between Columbia and its upstream suppliers. 19/

Once downstream pipelines were permitted to account for Order No. 500 direct bills in Account No. 803, while upstream pipelines were still required to record precisely the same buyout/buydown costs in Account No. 813, a literal application of the WACOG test would frustrate the parties' intent to rely on that test to serve as a basis for a meaningful comparison of the purchased gas costs of Columbia vis-a-vis its upstream suppliers. Thus, to ensure a consistent application of the WACOG test as between Columbia and its pipeline suppliers, the Commission stated in its rehearing order that:

> take-or-pay costs should not be included in the WACOGs of the five other pipelines to which Columbia's WACOG is compared under the 1985 settlement. The instant rehearing order does not foreclose Columbia from refiling a surcharge, if elimination of take-or-pay costs from the WACOGs of the five pipeline suppliers would result in Columbia meeting the necessary threshold.

R. 247 n.11, J.A. 111 n.11; 59 FERC at p. 61,795 n.11. Accordingly, Columbia cannot seriously claim that the Commission has frustrated the parties' intent by interpreting the WACOG test of Appendix F--which was designed to measure Columbia's progress in reducing its actual purchased gas costs--as requiring Columbia

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19/ As previously noted, since the 1985 decisions in Columbia Gas Transmission Corp. v. Tennessee Gas Pipeline Co., 31 FERC ¶ 61,053, at p. 61,105 nn. 14-15; Tennessee Gas Pipeline Co., 31 FERC ¶ 61,052, there has never been any change in the manner in which upstream pipeline suppliers account for take-or-pay settlement costs to the producers of gas--which still requires the use of Account No. 813.

to treat non-PGA costs consistently with the treatment of those same costs by upstream suppliers for comparison purposes. 20/

II. THE COMMISSION PROPERLY REJECTED COLUMBIA'S TARIFF FILING WITHOUT A FORMAL EVIDENTIARY HEARING

Nor is there any merit to petitioner's claim that the Commission should have accepted petitioner's proposed tariff filing, suspended it, and convened a formal evidentiary hearing. It is well-established that when the Commission receives a utility application to increase rates that is barred by contractual provisions, as Columbia's surcharge was in this case, the Commission has a duty to reject the rate filing under the Mobile-Sierra doctrine. See United Gas Pipe Line Co. v. Mobile Gas Service Corp., 350 U.S. 332, 347 (1956); FPC v. Sierra Pacific Power Co., 350 U.S. 348 (1956); Richmond Power and Light v. FPC, 481 F.2d 490, 501 (D.C. Cir. 1973), cert. denied, 414 U.S. 1068 (1973); see also Mississippi Valley Gas Co. v. FERC, 659 F.2d 488, 498 (5th Cir. 1981); MCI Telecommunications Corp. v. FCC, 665 F.2d 1300, 1303 (D.C. Cir. 1981). 21/ According-

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20/ In any event, the refunds that Columbia credited to its Account No. 803 for the purposes of applying the WACOG test of Appendix F were only estimates of what Columbia would receive from its upstream suppliers' Order No. 528 filings, and thus were not intended to be the subject of Columbia's 1990 WACOG test. As the Commission observed, "by the end of 1990, only one of Columbia's upstream suppliers had even made an Order No. 528 filing and the Commission had not made any final decision on that filing." R. 246; J.A. 110; 59 FERC at 61,794. Thus, as it proceeded to explain, the take-or-pay refunds are "not related to actual gas costs in the year in question." R. 246, J.A. 110.

21/ Under the so-called "Mobile-Sierra doctrine" (United Gas Pipeline Co. v. Mobile Gas Service Corp., 350 U.S. 332 (continued...)

ly, once the Commission determined that Columbia failed the 1990 WACOG test, and therefore was contractually prohibited from collecting the surcharge, the Commission properly rejected Columbia's tariff filing.

Nor did Petitioner establish any basis for convening a formal evidentiary hearing. Petitioner made no proffer of evidence that would support convening such a hearing. Petitioner, which relied essentially on the plain language of Article IV of the settlement, did not challenge the fundamental premises for the Commission's finding--that Order No. 500's change in the way take-or-pay costs were to be recovered, and the accounting policy change for Account No. 803 in April 1989, were unforeseen by the parties in 1985. Nor did petitioner challenge the Commission's finding that WACOG historically was viewed by the industry as relating only to costs recoverable through the PGA. Petitioner likewise did not take issue with any of the historical facts that the Commission relied on in determining that the WACOG test of Appendix F was intended to include only

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21/(...continued)
(1956); FPC v. Sierra Pacific Power Co., 350 U.S. 348 (1956)), the Commission cannot allow a utility to increase its rates beyond those specified in its contract with its customers merely on the ground that the contract does not allow it to earn a fair return; instead the Commission must find that the rate is "so low as to adversely affect the public interest--as where it might impair the financial ability of the public utility to continue its service, cast upon other consumers an excessive burden, or be unduly discriminatory." FPC v. Sierra Pacific Power, 350 U.S. at 355. Columbia has made no claim in this proceeding that, absent the surcharge, its rate will be so low as to adversely affect the public interest.

actual PGA-authorized gas costs, not non-gas costs which made their way into Columbia's Account No. 803 through an unforeseen accounting changes.

Under this Court's established precedent, an evidentiary hearing is not required when there are no material facts in dispute. As this Court stated in Kansas Power & Light Co. v. FERC, 851 F.2d 1479 (D.C. Cir. 1988):

> [T]he standard of review which applies to an agency's decision to forego an evidentiary hearing in the absence of a disputed factual issue is quite narrow. Moreover, mere allegations of disputed facts are insufficient to mandate a hearing, and this Circuit has in the past accorded considerable deference to determinations by the Commission that the petitioner failed to make an adequate proffer of evidence to support [its allegations of disputed facts.]

Id. at 1484, citing Cerro Wire & Cable v. FERC, 677 F.2d 124, 129 (D.C. Cir. 1982); General Motors Corp. v. FERC, 656 F.2d 791, 798 n.20 (D.C. Cir. 1981) (inside quotation marks omitted). Accord, Woolen Mills Associates v. FERC, 917 F.2d 589, 592 (D.C. Cir. 1990).

Here, Petitioner failed to cite any issue of material fact that was in dispute and has never made any proffer suggesting that the parties to the 1985 PGA settlement agreed to be bound by unforeseen regulatory changes concerning take-or-pay cost recovery and accounting policy. Nor did Petitioner file any affidavits from witnesses who would be prepared to testify about negotiations, admissions, or other events that would lend support to its position that the parties intended the WACOG test to be modified by future regulatory changes. Rather, petitioner simply asserted, and continues to assert, that the Commission's interpretation raises a question of intent that "would benefit from further ventilation of the underlying facts." Pet Br. 34. See also Pet. for Reh. at pp. 16-18; R. 233-35, J.A. 99-101. Such generalized assertions do not support it claim that the Commission erred by declining to hold an evidentiary hearing under the standard articulated by this Court in cases like Kansas Power & Light. 22/

22/ Petitioner's reliance on Cajun as authority for the proposition that the Commission must set the questions about the proper interpretation of ambiguous contracts for an evidentiary hearing is misplaced. In Cajun, the Commission failed to acknowledge any ambiguity in what this Court found to be a patently ambiguous agreement, and therefore, it failed to consider extrinsic evidence of intent. In this case, the Commission did consider extrinsic evidence of intent, basing its decision largely on what the state of the law was at the time of the 1985 PGA settlement, and the parties' expectations as of 1985.

In contrast, it is Columbia that has argued that the WACOG test of Appendix F and Table 1 of the 1985 PGA settlement are clear and unambiguous, and the Commission therefore was not entitled to rely on extrinsic evidence.

CONCLUSION

For the foregoing reasons, the Commission's orders should be affirmed.

Respectfully submitted,

Susan Tomasky
General Counsel

Jerome M. Feit
Solicitor

Joseph S. Davies
Deputy Solicitor

Edward S. Geldermann
Attorney

Federal Energy Regulatory
Commission
Washington, D.C. 20426
(202) 208-0177

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