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New Mexico's Natural Gas Pricing Act

Kathleen R. Marr

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NATURAL RESOURCES LAW–NATURAL GAS PRICING: New Mexico becomes first energy-producing state to enact legislation regulating the price on intrastate gas supplies. 1977 N.M. LAWS, ch. 73.

In anticipation of a partial deregulation of natural gas by the federal government, the 1977 Session of the New Mexico Legislature enacted the Natural Gas Pricing Act, which placed a price ceiling on intrastate gas produced or sold at the wellhead.[1] New Mexico thus became the first energy-producing state to regulate the price of natural gas in intrastate commerce. A unique combination of factors prompted the state to take this action. The price of intrastate gas in New Mexico had for several years been subject to open-ended price escalation clauses in the contracts between most producers and the primary supplier, Gas Company of New Mexico. These clauses, commonly called favored nations clauses, generally triggered an automatic increase in the contract price to the highest price the supplier paid any one producer.[2] If, for example, Gas Company paid a higher price for natural gas to one producer, it was bound by the contract to pay the higher price to all producers. By 1974, disputes between various parties had arisen over interpretation of the clause, and as part of a 1976 settlement of a lawsuit to interpret the clause, all contracts were amended to delete the favored nations provision and substitute in its stead a new escalation approach called price redetermination.[3] In principle and in its ultimate result, price redetermination was essentially the same as the favored nations clause. However, instead of being triggered by the highest price paid any producer covered by the contract, price redetermination was keyed to a weighted average of the two highest prices paid in the northwest quadrant and the two highest prices paid in the southeast quadrant of the state.[4] Following an initial adjustment stipulated by the agree-

1. 1977 N.M. LAWS, ch. 73.
2. ENERGY RESOURCES BOARD, A STATE ENERGY PLAN FOR NEW MEXICO (1976) [hereinafter cited as 1976 ENERGY PLAN].
3. Interview with Joan Ellis, Attorney, Energy Resources Board (Sept. 22, 1977).
4. Continental Oil Co. v. Southern Union Gas Co., No. 48543 (1st Jud. Dist., N.M.) Settlement Agreement, June 28, 1976.

ment, the price of intrastate gas was to be redetermined or adjusted annually.

When considered in connection with the three-tiered pricing structure of natural gas maintained by the Federal Power Commission (FPC), the price redetermination provision had serious economic implications. The three-tiered pricing structure, which had developed over a period of years, set one price for interstate gas discovered before 1973 (old gas), a somewhat higher price for gas dedicated between 1973 and 1975 (newer gas) and a still higher rate for gas drilled after January 1, 1975 (new gas). Even though old gas constitutes about 85 percent of both the interstate and intrastate supply in New Mexico, the price redetermination clause created a significant disparity between the average price of each.[5] Taking into account the higher price levels permitted for newer gas and new gas, the average price of interstate gas would be close to, but somewhat higher than, the rate for old gas alone. However, because of the price redetermination clause, the average price of intrastate gas would eventually be closer to the price of new gas. The price paid for that small portion of intrastate gas which is new gas, would, therefore, set the price for all intrastate gas covered by price redetermination provisions. Moreover, Gas Company largely services a residential market, which requires much larger quantities of gas during the winter heating season than during the summer months. In order to insure adequate supplies for a market with fluctuating demand, it often has to pay a premium price for new gas above that set by the FPC.[6] Thus the average price for intrastate gas had the potential of being even higher than the FPC price for new gas.

In 1976, the FPC issued two opinions that established a new interstate ceiling price for new gas and newer gas and reaffirmed the maximum interstate price for old gas, which it had announced in an earlier opinion. Opinion No. 770, published on July 27, 1976, set the ceiling price for new gas at $1.42 a thousand cubic feet (MCF), with a one cent increase allowed every quarter, beginning October 1, 1976.[7] For newer gas, it established a maximum price of $1.01, which was later modified by Opinion No. 770-A to $.93, with a one cent increase permitted each calendar year. Opinion No. 770-A, which was issued on November 5, 1976, also reaffirmed the uniform base rate for old gas at $.295 per MCF, with some provision for renewal of expiring contracts to $.52.[8] These opinions confronted

5. 1976 ENERGY PLAN.
6. *Id.*
7. FEDERAL POWER COMMISSION, 1976 ANNUAL REPORT.
8. *Id.*

New Mexico with the probability that the average price for intrastate gas would within a short period become considerably higher than the average price for interstate gas. Indeed, the state estimated that the premium price Gas Company would have to pay for new gas could easily reach $2.00 per MCF.[9]

Even more ominous was the passage of a bill in the U.S. Senate that would have deregulated the price of new gas.[10] Although a similar bill in the House of Representatives was subsequently defeated by a vote of 205 to 201, the margin was so narrow that its enactment seemed likely within the foreseeable future. Under such a partial deregulation scheme, the price of new gas on the interstate market could easily rise to very high levels, possibly even to $5.00 per MCF.[11] Because of the triggering mechanism of the price redetermination clause, much of the gas on the intrastate market would soon rise to this highest price.

The economic hardship and dislocation visited on New Mexico by such a price increase would almost certainly be severe. The state would be in the absurd position of exporting natural gas at a much lower rate to other states than it could provide to its own citizens. Moreover, because New Mexico has one of the lowest per capita incomes in the nation, ranking 45th, many of its people simply could not afford the consequent three to four-fold increase in natural gas bills. Also, the shortage of natural gas, which the state had already begun to experience, would probably become more widespread.[12] All of these factors would seriously impair New Mexico's efforts to attract new industry and could result in its losing industries heavily dependent on reasonably priced natural gas.

In order to respond effectively to this problem, the State of New Mexico considered numerous possible remedies, including the hitherto unprecedented step of imposing price ceilings on its intrastate supplies of natural gas. After much discussion and debate during its 1977 Session, the New Mexico Legislature approved, and the Governor signed into law, such a piece of legislation entitled the "Natural Gas Pricing Act." The Act represented a compromise

9. 1976 ENERGY PLAN.

10. Interview with David Bloom, former Deputy Director, Energy Resources Board (Sept. 29, 1977).

11. 1976 ENERGY PLAN.

12. Peculiarities of supply were responsible for the shortages experienced by New Mexico communities in 1976. Some communities in the southwest quadrant of the state purchase their natural gas from interstate pipelines as there are no intrastate pipelines to serve them. Since almost all of the newly discovered gas over the last five years was being sold on the intrastate market, the interstate pipelines were not able to operate at full capacity. *Supra* note 10.

between producers and consumers. The maximum allowable base price of $1.44 per MCF, which it established on all natural gas produced and sold in intrastate commerce from wells drilled prior to January 1, 1975,[13] gave the producers the price they would have gotten eventually under the price redetermination clause as a result of FPC Opinion No. 770. It also protected the gas utilities by guaranteeing them an adjustment of their rates and tariffs should they have to pay more than $1.44 per MCF because of the unconstitutionality of any portion of the Act. In addition, the Act provided for its automatic termination on June 30, 1979 or 30 days after the total deregulation of all natural gas sold in interstate commerce, whichever came first.[14] With respect to the consumer, the Act provided protection from economic adversity by insuring that intrastate gas would be available at a reasonable price. It accomplished this not only by placing a price ceiling on most intrastate gas but by prohibiting the abandonment of any facility producing and selling intrastate gas without the permission of the New Mexico Public Service Commission.[15] The Act also served the consumer's interest by requiring any producer who knowingly received more than the maximum allowable price to refund the excess payment to the purchaser and to pay a fine of triple the amount of the excess. It gave the Attorney General the responsibility of enforcing the price ceiling and the authority to restrain by injunction excess payments to a producer.[16]

Perhaps the most remarkable aspect of the Act is that it was passed by an energy producing state. New Mexico is a major source of oil, coal, and uranium, and its natural gas output is exceeded by only three other states. Though the reasons for its passage were varied, one of the most important was certainly the relatively equal political strength of producer and consumer interests. Unlike Texas, where the political power of the oil and gas industry is pervasive throughout the state, only eight of thirty-two counties in New Mexico produce oil and gas.[17] New Mexico's two largest metropolitan areas, Albuquerque and Santa Fe, are not within those counties and have strong consumer interests. Moreover, two of the communities that experienced shortages of natural gas in the year prior to the 1977 legislative session were each represented by powerful political figures in the state senate.

In light of the current debate in the U.S. Congress over the deregu-

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13. 1977 N.M. LAWS, ch. 73, § 6.
14. 1977 N.M. LAWS, ch. 73, § 10.
15. 1977 N.M. LAWS, ch. 73, § 9.
16. 1977 N.M. LAWS, ch. 73, § 8.
17. *Supra* note 10.

lation of natural gas, the Act appears to be a particularly timely and foresighted piece of legislation. The House recently adopted the President's proposal to raise the price of new gas to $1.75 per MCF.[18] But the Senate has again, as in 1976, expressed itself in favor of the partial deregulation of natural gas, which would result in much higher prices for new gas than would the House bill. The conference committee, which will seek to compromise the differences between the House and Senate, is expected to agree to a price ceiling in the neighborhood of $2.00 per MCF on new gas. Whatever action may emerge from Washington, the Natural Gas Pricing Act will protect New Mexico until June 30, 1979 from any significant increases in intrastate rates. Equally as important, the Act will give New Mexico the opportunity to analyze the need for further state action and sufficient time, if required, to harmonize the diverse interests of its citizens.

KATHLEEN R. MARR