ORIGINAL

SUPREME COURT OF THE UNITED STATES

In the Matter of:

FEDERAL ENERGY REGULATORY COMMISSION,

Petitioner,

v.

MARTIN EXPLORATION MANAGEMENT COMPANY, ET AL.; and

No. 87-363

PUBLIC SERVICE COMMISSION OF NEW YORK, ET AL.,

Petitioner,

v.

MARTIN EXPLORATION MANAGEMENT COMPANY, ET AL.

No. 87-364

Pages: 1 through 45

Place: Washington, D.C.

Date: March 28, 1988

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Washington, D.C.

Monday, March 28, 1988

The above-entitled matter came on for oral argument before the Supreme Court of the United States at 10:02 o'clock a.m.

APPEARANCES:

RICHARD G. TARANTO, ESQ., Assistant to the Solicitor General, Department of Justice, Washington, D.C.; on behalf of the petitioner in No. 870363.

RICHARD A. SOLOMON, ESQ., Washington, D.C.; on behalf of the petitioners in No. 87-364.

JEFFREY S. DAVIDSON, ESQ., Washington, D.C.; on behalf of the respondents.

I N D E X

P R O C E E D I N G S

(10:02 A.M.)

CHIEF JUSTICE REHNQUIST: We will hear argument first this morning in Number 87-363, Federal Eenergy Regulatory Commission versus Martin Exploration Management, Number 87-364, Public Service Commission of New York versus Martin Exploration Management Company.

Mr. Taranto, you may proceed whenever you are ready.

ORAL ARGUMENT OF RICHARD G. TARANTO, ESQUIRE

ON BEHALF OF THE PETITIONER IN NO. 87-363

MR. TARANTO: Mr. Chief Justice, and may it please the Court, this case concerns the process of deregulation under the Natural Gas Policy Act of 1978. That Act divides natural gas into a number of categories. Those categories overlap. Some of the categories are subject to price ceilings. Some are now deregulated. Producers have gone to the agencies that handle the qualification of gas for sale in particular categories, and have obtained qualifications for some gas in both the regulated and deregulated category.

The principal question in this case is how such gas should be treated for purposes of determining the price at which it may lawfully be sold. The Commission concluded that such so-called dual qualified gas should be treated as deregulated.

We are here asking this Court to uphold the Commission's view of the statute, and to uphold a second Commission ruling which gave rise to the second question in this case and which I plan to discuss at the end.

In considering how this case arose it is useful to have in mind one very common type of gas sale contract that producers entered into in the mid to late 1970s and early 1980s. Those contracts were for long terms, 20 years or more, and they expressly anticipated the coming deregulation in 1985 and 1987 of the most important of the categories of natural gas under the NGPA.

The contracts provided that until deregulation occurred the gas would be sold at the highest applicable ceiling price set by law or Commission order, and when deregulation occurred, either the price would be renegotiated or it would be determined by reference to some market price.

To ensure the highest possible ceiling price during regulation while providing in advance for a change in pricing upon deregulation, producers obtained qualifications for particular quantities of gas in several different categories under the NGPA, some of which would be deregulated in a few years.

Gas at the time was in very short supply. Market prices were high, and it looked like prices were going to continue to rise into the indefinite future. Producers included the deregulation clause in their contracts in the expectation that when deregulation occurred they would obtain higher prices under those clauses.

As the May 1985 deregulation date approached, market prices had dropped drastically and were now well below ceiling prices in some of the alternative categories for which producers have qualified their gas. Many producers therefore sought to escape deregulation clauses in their contracts by trying to prevent their gas from becoming deregulated and having it treated under one of the still regulated categories for which it had been qualified.

The Commission in late 1984 proposed and issued a rule that rejected this effort. The rule stated, when gas has been qualified in the deregulated category, it must be treated as deregulated, even if it also happened to be qualified for a still regulated category.

On review, the Court of Appeals concluded that the Commission had misconstrued the NGPA. It declared a different rule for how to treat gas that falls into a regulated-deregulated overlap. The Court of Appeals rule says look at individual producers' contract prices and let the producers choose the category under the contracts that actually results in the highest price.

This means that two producers with precisely the same overlap of pricing categories can be subject to different legal treatment depending on what prices they happen to include in their contracts. What is more, the producers can make the change of status daily. Depending on market conditions, they can move the gas back and forth between regulated and deregulated status whenever the deregulated price exceeds the regulated price.

We think the Commission's view is much the better reading of the NGPA. It is a better interpretation of the relevant statutory language and more in accord with the overall NGPA scheme of phased-in deregulation.

First, Section 101(b)(5) of the Act, which addresses the general question of how to treat gas that is qualified in two categories, says that if more than one of the NGPA pricing provisions applies, "the provision which could result in the highest price shall be applicable."

That language does not, as the Court of Appeals thought, refer to particular producers or to their contract prices. It requires a determination of which of several statutory ceiling prices is the highest. The provision with the highest ceiling price is the one that "could result" in the highest price, and of course if one provision says that there is no ceiling price, that is the provision that could result in the highest price, and so the gas must be treated under that provision, that is, it is deregulated.

That Section 101(b)(5) should be read as concerned only with ceiling prices and not with particular contract prices is also supported by the approach taken to price regulation by the NGPA as a whole. The NGPA only sets ceilings, and in fact it expressly provides that the Act is concerned with producers' contract prices only to the extent of ensuring that they are below any statutory ceiling.

In addition, the contracts like the ones I described at the outset show that it is the law that was meant to determine when gas is deregulated under produers' contracts, not the other way around. It is not the contracts that determine when the gas is deregulated under the law. One clause of those contracts says, if the gas is regulated, a specified price, often the legal maximum, will apply. Another clause says, if the gas is deregulated the price is determined by renegotiation or some market reference.

The contracts look to some external action by law or regulation to determine which of those clauses applies. In fact, there would be a serious circularity if the statute required reference to the contracts, which then required reference back to the statute, and so on.

The Court of Appeals' view would also transform the statute from one that set ceilings to one that established price floors. Ceiling prices set for a regulated category could always be charged by prdoucers, even if market prices were lower. That turns the statute upside down. There is not the slightest indication that Congress believed that the problem with the market was that deregulated prices were too low. Indeed, the very nature of a price ceiling is that it is intended to hold prices down. That view is confirmed by Congress's overall plan in the NGPA for phased-in deregulation. Congress did not intend to create a scheme of ever-increasing producer price subsidies, with the producers always having the option to select a higher regulated price even when market conditions did not justify such a price.

Rather, Congress intended that a market mechanism with all of its natural consequences would be introduced for the determination of prices and levels of production of the designated kinds of gas. Again, the NGPA as a ceiling price statute is not a producer subsidy statute.

The Commission's view is further confirmed by evidence that Congress intended --

QUESTION: Mr. Taranto, perhaps I am naive, but if some of this gas is deregulated and some isn't, and the deregulated price is lower, who buys the stuff at the higher price?

MR. TARANTO: The answer to that question turns on when the contracts were made. In the current market, gas is sufficiently plentiful that new contracts are indeed being written so that purchasers never pay more than the deregulated price. What is principally at issue in this case is a whole series of contracts written from the mid-seventies until the early eighties, very long-term contracts in which producers and purchasers locked themselves into -- into contracts that did not provide for a maximum deregulated price, so the purchasers here under these contracts if the regulated category applies would be stuck at that regulated ceiling.

QUESTION: But it is not a question just of contract interpretation then.

MR. TARANTO: No, the contracts themselves look to the statutory regulatory interpretation in order to determine which clause of the contracts applies. Ultimately the price that a producer can obtain from a purchaser does turn on the contract, but again, those contracts look back to the regulatory status to determine which clause is applicable.

QUESTION: Mr. Taranto, would you explain how the circularity problem arises with the Court of Appeals' interpretation?

MR. TARANTO: Well, the contracts as I describe as written say in one clause if the gas is regulated then a certain price applies, or the maximum legal price applies. If the gas is deregulated, then some other mechanism for determining price is triggered, either reference to some market or what is quite common, a renegotiation. Those contracts are written on the assumption that some external action,that one would have to look to what the statute says or what the Commission has done in order to determine which of the contract clauses applies.

The circularity that I referred to would arise if the statute itself required a reference to the particular contracts to determine which of the clauses applies, and the clauses of the contracts themselves then required a reference back to the statute to determine which applied.

QUESTION: They wouldn't. I mean, you'd be able to -- I don't see how you end up in any circularity. It may be a strange situation, but you would still be able to know from looking at the contract whether the -- either --- if it's a renegotiated price it obviously could be higher than the ceiling price, and if it is a fixed price in absence of regulation you can look at what that fixed price would be. It seems to me you would be able to tell from looking at the contract whether it could be higher or not. There is no impossibility as there is in some circularity problems where you can't get off the -- can't get off the merry-go-round. You can get off here, can't you?

MR. TARANTO: That's right, I think one can get off, and with a renegotiation clause, as the Court of Appeals pointed out, typically where one would get off is at the regulated price, because the producer would have no incentive to renegotiate below the regulated price.

My reference to the circularity was to reflect the assumptions of all the contracting parties of the time as to which of the two places, the contract or the law, would determine the applicable category.

QUESTION: Counsel, you have really already addressed the argument in part by saying that you think there's nothing in the overall scheme of the Act that indicates Congress wanted the highest price at all times, but that means, though, that the last clause of the sentence that we're -- the section we are looking at is a little bit out of step with the scheme of the Act, doesn't it, because it does say the provision which could result in the highest price shall be applicable, and when one first looks at this case, it looks like there's a policy for the Congress to allow the maximum price.

MR. TARANTO: I think the policy here is to allow the maximum permissible price set by law with parties free to negotiate under that ceiling according to their bargaining power and market conditions. That's why we stress so much the words "could result in the highest price." To read the "could result" language here as referring to the highest price set in a particular producer's contract would really make this provision an anomaly in a statute that otherwise is not concerned at all with contract prices but simply says you may charge no more than a certain level. We think the language "could result in the highest price" is an explicit reference to a ceiling price.

Congress, as I had suggested, had no intent to allow producers to opt out of deregulation and return gas to regulated status when market conditions did not prop up prices to the level set in the statute for particular categories. Congress intended a one-way transition to deregulation.

That basic design of the statute which generally deregulates new gas indicates that Congress intended market forces to apply to an ever-increasing proportion of the market as old gas was generally depleted and a higher and higher proportion of the gas available in the market became new gas.

And finally, the possibility that deregulated gas would come back under regulation is one that Congress did address in Section 122 of the Act, and it provided there precisely one mechanism for a return ot regulated status, action by Congress or the President one time, and only temporarily.

Congress did not envision daily returns of regulated status -- to regulate status at producers' option into the indefinite future.

Finally, let me say a word about the second question in this case. Section 107(c)(5) of the Natural Gas Policy Act allows the Commission to define categories of gas that would get special production incentive pricing. The Commission defined a category called new type formation gas, and said that in order to ge qualified in that category gas must first be determined to meet the qualifications under Section 102 or 103. That definition is not challenged. What is challenged is the Commission's subsequent declaration that state and federal agencies when they granted a qualification as new type formation gas must be treated as simultaneously having granted the qualification under Sections 102 or 103, which they had to determine to be applicable in order to grant the new type formation status.

This ruling, which means deregulation of the gas is a reasonable exercise of the Commission's power, including most notably its power of definition under Section 107(c)(5). It imposes no additional burden on the state and federal agencies that handle the qualification process. It merely implements the unchallened definition, and it sensibly declares that the special production incentive pricing should not be available for a category of gas whose production levels can be set by the market.

QUESTION: May I ask you one question about the first issue in the case rather than the one you just addressed? Have you abandoned reliance on Section 121?

MR. TARANTO: No, we rely on Section 121, but in court we rely on it as additional evidence of how 101(b)(5) should be interpreted. We have not in this Court pressed the argument that 101(b)(5) is inapplicable and 121 by itself in isolation answers the question.

QUESTION: Thank you. You have not, however, as respondent's brief asserts, conceded that their interpretation is correct?

MR. TARANTO: No, we haven't. We have simply omitted one of the arguments we made in the Court of Appeals from our petition in this case.

QUESTION: You tell me, on the second issue, the one thing that concerns me about it is, there does seem to be a requirement -- well, there is a requirement for determination. The determination has to be made by the state authority, not by FERC, but it is the scheme that you don't get a determination unless you apply for the determination, and it sort of gives the produder the option to pick the category that would be most advantageous for that producer.

Doesn't the way FERC is managing this deprive the producer of that option?

MR. TARANTO: Well, we think that the option of producer choice of qualification can't be stated quite so broadly as the Court of Appeals did. Given the Commission's power, several powers, including its power to define Section 107(c)(5) gas in the first place, it could have, for example, here simply said, gas qualifies as new type formation gas if it meets the following qualifications but not if it also falls into Section 102 or 103.

QUESTION: I see.

MR. TARANTO: And thereby just diminished the definition so as to exclude precisely the cases that it has provided for deregulation in this manner, but in addition the Commission does have a role in the qualification process. It has given general regulatory power. It has given the power to establish what information must be supplied to the state agencies in the producer filings, and it is given a review process -- a role in the review process.

We think the Commission's general regulatory power is sufficient given its role in the review process to require this departure from the otherwise general rule of producer selection of the qualifications that they apply for in this category of Section 107(c)(5) where it has the power to exclude this class of cases from the definition in the first place.

I would like to reserve the remainder of my time for rebuttal.

CHIEF JUSTICE REHNQUIST: Thank you, Mr. Taranto.

We will hear now from you, Mr. Solomon.

ORAL ARGUMENT OF RICHARD A. SOLOMON, ESQUIRE

ON BEHALF OF THE PETITIONERS IN NO. 87-364

MR. SOLOMON: May it please the Chief Justice, Members of the Court, the petitioners in 364, the Public Service Commission of the State of New York, the Associated Gas Distributors, the Panhandle Eastern Pipeline, and the Tennessee Gas Pipeline, have joined together in their petition here because what we believe the lower court's opinion erroneously has done is to prevent pipelines from the benefits of their bargains as to how gas should be priced under deregulation while at the same time allowing producers to have the benefits of those bargains, and unfairly rasing prices.

Now, we agree completely with the position taken by Mr. Taranto as to the construction of 101(b)(5). We would point out that for the court's opinion below to be upheld, it is not sufficient for my friends over here to demonstrate that their construction of 101(b)(5) is a possible one.

They have to show that the Commission's construction of 101(b)(5) is an impossible one, because if

101(b)(5) is subject to two interpretations we think it's clear for reasons detailed in the Commission's brief and our brief that of the two possible interpretations under such circumstances the Commission's interpretation is much more in accord with the structure and intent of the Act than the Court of Appeals.

Let me interrupt myself and answer your question, Chief Justice Rehnquist. You were wondering why people would buy high-priced gas, and the answer is a contractual one. These contracts not only provide for pricing, but they also provide for take or pay. In other words, if you are fortunate enough to have -- to be a producer with a high priced contract, you also have with that contract an obligation for the customer to take 85 percent, 90 percent, some cases even 100 percent of the maximum deliverability.

So while given their choice obviously pipelines would take the lower cost gas, they are not given their choice in all too many cases, and that's the point on high priced gas versus low priced gas.

QUESTION: You're not contending that's unfair. I mean, that's the deal they cut, right? I'm over here. I say, you are not contending that that's unfair?

MR. SOLOMON: The take or pay provisions are part of the --

QUESTION: You traded that for --

MR. SOLOMON: They are not unfair.

QUESTION: You traded that for the guaranteed deliverability over, what, some of them are 20-year contracts, aren't they.

MR. SOLOMON: Well, whatever a contract is. I would say they are more life of lease contracts than 20-year contracts nowadays. I am saying the take or pay is part of the underlying of what happens that answers the Chief Judge's question of why people take high priced gas and therefore why it's important to get this case resolved properly so that this artificial --

QUESTION: But there is nothing unfair about it now. You are not asserting that.

MR. SOLOMON: We argue it is unjust and unreasonable, but that's a different issue that has come up in a different court. It is not illegal unless it's declared illegal.

QUESTION: You wouldn't want those contracts, that form of contract outlawed, would you?

MR. SOLOMON: We would perhaps want to have take or pay contracts reduced, and we are so arguing to the Commission, and this was the issue in a case before the Court of Appeals, but that's not what I'm discussing here today.

Justice Stevens, we do rely on Section 121 as well as 101(b)(5), which we think are consistent with one another. We do think, and the Commission said this, too. It's not just something we are dreaming up. We do think that Section 121 of the Act in and of itself makes clear that what is involved in the deregulation process is the removal of all price controls from the specific types of gas which are deregulated. Certainly that's what Congress thought that language meant, because if you look at the conference agreement explaining what 121 of the Act means, what they say, and I'm reading from Page 92 of the conference agreement, they say the conference agreement provides for the elimination of federal price controls for certain categories of natural gas.

Thus the agreement -- that's the statute -- deregulates those categories for ceiling price purposes. In other words, as we believe and have argued, the language of 121 also makes clear what was being deregulated were categories of gas, and what that deregulation did was to make inapplicable the price control provisions of Title 1, and that is, of course, the ceiling price.

So we believe that the Commission was clearly correct in its interpretation of Section 121 and that that is an additional reason supporting the Commission's interpretation of 101(b)(5). They are consistent, and they are both at least as good a construction of those two sections as the decision below.

Now, the Court did not disagree with the Commission's interpretation of 121. On the contrary, it said it was a rational position, but then said it was overruled by their construction of 121 -- I mean, 101(b)(5). Now --

QUESTION: Mr. Solomon, does it make any difference for purposes of other activities under the Act which of those interpretations -- suppose we come out your way. Does it make any differences for purposes of other provisions in the Act which of those two theories we take?

MR. SOLOMON: Whether you take 121 or whether you take 101(b)(5)? I don't think so. I think they are consistent, and are saying in different ways -- one is in the language of the deregulation itself and the other is a rule of construction. The same thing.

As I said, the court position is entirely based on the fact that the Commission's construction of 101(b)(5) can't be right, and the reasons the Court of Appeals judge gave for her views are set out essentially on Page 16 of the Joint Appendix, 16A of the Joint Appendix.

And what you see she is saying there is, she says the deregulated price is theoretical, and while it could be higher, there are all sorts of provisions for raising the other ceiling prices, and therefore maybe they could be higher at some time.

But the answer to that is the X plus one rule. Whatever price a ceiling is raised to, the absence of a ceiling allows you to set a price one cent or more higher. And therefore her argument as to -- on Page 16 as to why the Commission's position can't be right is in our view clearly wrong.

What is more, she talks about the price of regulated gas could be higher than the price of deregulated gas. That, of course, is true under the contract, and that is what this whole case is about, but while the price of regulated gas under a contract can be higher under certain circumstances than the price of deregulated gas under a contract, the statute says that the applicable provision of the Act, either this regulated price or a nonregulated price, is what could lead to the higher price, and the Commission is obviously right that what could lead to the higher price is the absence of regulation. It may not lead to a higher price. What this case is all about is, faced with this statute, a number of producers and pipelines agreed to contracts which said, in the event of deregulation the price shall be X, usually they said, immediately on deregulation it will stay the same as it was, but it shall be subject to bilateral renegotiation.

The thought at the time, the producers thought at the time that bilateral renegotiation would raise the price above what it was, but the pipelines insist that if you are going to get this right, make it bilateral so that if the situation --

CHIEF JUSTICE REHNQUIST: Mr. Solomon, Mr. Solomon, your time has expired.

MR. SOLOMON: Thank you.

CHIEF JUSTICE REHNQUIST: Thank you.

We will hear now from you, Mr. Davidson.

ORAL ARGUMENT OF JEFFREY S. DAVIDSON, ESQUIRE

ON BEHALF OF THE RESPONDENTS

MR. DAVIDSON: Mr. Chief Justice, and may it please the Court, the unanimous Court of Appeals correctly viewed this case as presenting a straightforward issue of statutory construction resolvable from the language of the statute itself as well as from the explanatory materials prepared by the conference committee.

But before I talk about the statutory language or the conference materials, I'd like to first briefly deal head on with certain other arguments that the petitioners have heavily relied upon in their briefs, and which were again referred to today in the oral argument.

Suggestions that this case raises some spectre of some anomalous regulatory burden due to gas switching in and out of regulation or the spectre of producers receiving above market prices and therefore some windfall unanticipated by Congress are not only tangential to the real legal issue in this case, they are demonstrably false. This case will determine if producers receive what are in every sense market prices they bargained for in their contracts with interstate pipelines and relied upon in exploring and drilling for certain kinds of gas for which Congress expressly provided special incentive ceiling prices --

QUESTION: Mr. Davidson, you say this case will determine whether the producers will receive the market prices they bargained for. Now, ordinarily in a contract you have a contract price that may not necessarily be the market price at all.

MR. DAVIDSON: In the contracts that were negotiated here, the prices that were arrived at in the contract are in fact market prices. They were prices that were negotiated between two knowledgeable and willing participants in the marketplace with equal bargaining power.

QUESTION: They were the market prices at the time the contract was negotiated?

MR. DAVIDSON: Yes, sir.

QUESTION: But that doesn't mean the market prices will necessarily correspond to the contract prices three or four years after the contract was executed.

MR. DAVIDSON: It does not mean that market prices negotiated into contracts today will be the same as those prices negotiated in the earlier contracts. That's true.

QUESTION: Well, it also means if you have a contract for over 20 years what you negotiate as a market price in the beginning of that contract may not be the same price you could go out on the open market and buy four years into the execution of the contract.

MR. DAVIDSON: That's absolutely correct. That doesn't change the fact that prices negotiated into that contract are by any definition when negotiated actual market prices and they are continued as such. As FERC itself was at pains to point out in Note 3 of its reply brief, market price merely means the price a particular purchaser can obtain -- a particular producer can obtain from a particular purchaser at a particular moment, and there could conceivably be as many market prices as there are producer-purchaser transactions, and that is certainly the case and certainly would be the case for a commodity like gas, which is historically priced pursuant to such long-term contracts.

In discussing these particular issues, let me start with the undisputable propositions that in the NGPA Congress established different categories of gas and set different ceiling prices for the various categories, and further, that against that regulatory framework producers and pipelines then negotiated different pricing provisions for the different NGPA categories, one example of which Mr. Taranto gave in his remarks.

For example, high cost, high risk Section 107(c)(5) gas may be priced according to, say, Paragraph 5(A) of the contract, whereas general new 102 gas may be priced according to Section 5(B). Categorizing gas as high cost and risk Section 107 gas means only that the parties themselves price the amount of that gas priced during the prior month according to Paragraph 5(A) of their contract rather than Paragraph 5(B).

There is no other regulatory consequence. In every respect relevant to this case the NGPA is merely a price ceiling statute. Saying that gas is "regulated" means only that it is subject to a ceiling price. It involves no certificates or filings or hearings or administrative proceedings.

So the fact that a gas is regulated or deregulated changes from one such category to another involves no regulatory burden on FERC or anybody else. It means only that the parties to a private contract themselves refer back to that contract to determine how that quantity of gas should be priced according to the particular contract provision that they have agreed upon.

The whole reason for Section 101(b)(5) being in the statute is that Congress knew the gas could be qualified in more than one such category. With respect to the particular kinds of gas which are really at issue in this case, high cost, high risk, section 107(c)(5) gas, and low production Section 108 stripper wells, gas of that type is virtually always, if not always at least qualifiable in one of the more generic NGPA categories. It is either old or new gas, offshore or onshore, interstate or intrastate, in addition to havint those special attributes which also make it qualifiable for Section 107(c)(5) or Section 108.

Now, despite the inevitably of such dual qualification for such gas, Congress provided in the NGPA that high cost and risk Section 107(c)(5) gas and stripper well 108 gas were entitled to higher ceiling prices, thus leaving producers free to try to negotiate higher prices for that kind of gas than they could obtain for the more generic kinds of gas that were subject to lower NGPA ceilings.

Now, where the producers were successful, such as in the case of my client, Martin Exploration, which entered into a long-term contract with the petitioner, Panhandle Eastern Pipeline, the price it negotiated for its high cost and risk gas is higher than the price for its more generic kinds of gas, but then it was always intended that that price be higher. These were prices negotiated under higher ceilings that Congress expressly labeled as incentive prices, designed to call out additional gas production on the margin, and in reliance on those higher prices which Martin negotiated in its contract with Panhandle, it went out and drilled and explored for this high cost and risk gas.

For Martin to now receive those higher incentive prices for that category of incentive gas is in no manner an unanticipated windfall, a producer assistance policy outside the parameters of Congressional debate, or any of the other labels that the petitioners have fashioned. To the contrary, such higher incentive prices were expressly intended by Congress in the NGPA for those particular kinds of gas.

Now, as to the level of those prices, let's start with the ceiling prices. Congress itself set the ceiling price for Section 108 stripper well gas in the NGPA, and in the context of this case none of us are free to question that judgment.

As for high cost and risk Section 107(c)(5) gas, FERC sets that ceiling price. It publishes it several times a year, and upon a proper record, can lower that ceiling price if it is in some way out of line or unjustified.

QUESTION: Mr. Davidson, let me interrupt you a minute. How did this case get into court?

MR. DAVIDSON: By filing an appeal from the Order 406 that FERC entered.

QUESTION: And what was the occasion for FERC entering Order 406?

MR. DAVIDSON: By occasion, sir, I'm not sure what you mean.

QUESTION: How did -- Order 406 was a regulatory order?

MR. DAVIDSON: Yes, sir.

QUESTION: What I am trying to find out is, why isn't this simply a contract case?

MR. DAVIDSON: It is not a contract case in the sense that what FERC is really done by this order is fore-ordained the result in all of the contract cases that could arise.

In other words, ultimately the parties to the contract themselves have to look at their contract to determine what happens upon deregulation of some categories of gas. What FERC Order 406 really does is to say that as a matter of law gas which is categorized in the Section 107(c)(5) or 108 category must be deemed to be deregulated. Indeed, even if --

QUESTION: And you have that term in your contract?

MR. DAVIDSON: The term in the Martin contract essentially is different from the one that Mr. Taranto gave an example of. In our contract, there is a fixed, in essence a fixed price established for deregulated gas, whereas gas that is properly qualified as incentive 107(c)(5) high cost and risk wells or low production stripper wells is entitled to a different negotiated price.

QUESTION: Why can't you simply sue your customer in court for the price you think is warranted under the contract?

MR. DAVIDSON: Because FERC has entered an order which says that that properly qualified 107(c)(5) and 108 gas is deemed to be deregulated 102 or 103 gas.

QUESTION: Well, what's the significance of that to your contract?

MR. DAVIDSON: Because that means that that gas automatically then qualifies under the category and must be considered to be gas sold under a category which is deregulated under the contract and thus is priced according to contract provisions which neither party ever intended to be applied to that kind of special gas. It foreordained the result.

QUESTION: But you are not arguing the intent of the parties here. You're not arguing this as if it were a contract case. You are arguing whether the FERC regulation is reasonable.

MR. DAVIDSON: Or just consistent with the statute --

QUESTION: Yes.

MR. DAVIDSON: -- I think is how I would rephrase it. That's correct. That's correct.

QUESTION: That seems -- well.

MR. DAVIDSON: The only point in going through the background is, there have been an awful lot of arguments that we've heard, which are again referred to here in the oral argument, about windfall prices and so forth, and really this just comes down to whether or not the producers can obtain the prices they negotiated for this kind of gas in their contracts.

QUESTION: Mr. Davidson --

MR. DAVIDSON: Yes, sir.

QUESTION: -- let me ask you a question. I suppose the contract could have provided that if 107(c)(5) gas is deregulated the parties shall continue to pay the price that was in effect immediately prior to deregulation. They could have agreed to do that, but instead -- am I right about that?

MR. DAVIDSON: Yes, if the parties had assumed that Section 107(b)(5) gas would be deregulated.

QUESTION: Yes, if they thought it was possible, they could have said, we'll continue to pay the same price, or some other category. But I guess at that time you probably didn't want to do that because you assumed at the time that upon deregulation the price would go way up.

MR. DAVIDSON: No, sir, we --

QUESTION: So you would have wanted to have the deregulated price.

MR. DAVIDSON: No, sir, there was no provision placed into the contract for what you should do if Section 107(c)(5) gas became deregulated because Section 107(c)(5) gas is never deregulated under the statute. That's what the statute says. So in the case of my client, Martin Exploration, which drills --

QUESTION: Statutes are amended, and I think these contracts envision that statutes are amended, and when some of them refer to deregulation of gas, they -- you mean, they don't include deregulation by amendment of the statute?

MR. DAVIDSON: I suppose that if Congress would pass an amendment amending the NGPA in a way that provided for deregulation --

QUESTION: I am rock bottom certain that that's what they meant and that that's what they do when they enter into these contracts. They envision that the law can be changed, and the price that they establish is the price that will take effect if and when the law is changed.

MR. DAVIDSON: That is possible, except in this case the NGPA has not been amended. Section 107(c)(5) gas has not been deregulated, and the contract provisions which were negotiated said that properly qualified 107(c)(5) wells were to be priced according to a particular contract paragraph, and the parties did not negotiate or even envision at that time in many of these contracts that that kind of gas would be priced according to an entirely different contract provision. There has been no amendment to the statute to change that situation, so that's the reason in the case of these special categories of gas.

QUESTION: Does the record contain an example of the text of the contract we're talking about?

MR. DAVIDSON: The record doesn't contain an example of any particular contract provisions that I'm aware of, although both of the petitioner's briefs contain references to examples of the kinds of contracts which exist.

QUESTION: The briefs do. Well, okay.

QUESTION: Is your answer to Justice Stevens' question that had you foreseen the present market conditions and had you even anticipated FERC's ruling, that you could have drafted the contract in order to get the result you wanted?

MR. DAVIDSON: With the benefit of hindsight, sort of the Monday morning quarterbacking, I suppose you can draft a contract to cover any eventuality. I don't think that there's any question about that, but the problem is that we did negotiate a contract under an existing statute that has not been changed, and in the case of Martin Exploration, for example, it's qualified its gas under the particular category that it thought would wind up giving it the highest price, and in its case did not even qualify the gas in any other category. It qualified its high cost and risk wells pursuant to Section 107(c)(5), and not according to any of the other deregulated categories.

What FERC Order 406 says is, notwithstanding that, that gas must be considered to be deregulated Section 102 or 103 gas, and since it automatically is deemed to be such deregulated gas it falls into a different contract provision.

That is the type of thing that is very hard to envision, and I suppose we could do that now with the benefit of hindsight, but it is difficult to imagine all the possible ways in which the law could be changed, and given retroactive effect in previously existing contracts.

QUESTION: Well, supposing you could show that it was the intent of both parties here that when you said unregulated gas, for example, you meant unregulated gas as you understood it, and regardless of anything FERC ever did about it. Would you be able to prevail on that view?

MR. DAVIDSON: Well, there will be underlying contract issues that could arise later on after this FERC order, but I think that if FERC's order is effective, which says that as a matter of law this certain kind of gas, which is 107(c)(5) gas, is to be deemed deregulated 102 or 103 gas. Under the wordings of the contract provisions, I am not sure whether that helps us.

QUESTION: Yes, but you won't be saying that if you get into court suing on the contract. You will be taking a more positive point of view, won't you?

MR. DAVIDSON: But the only consequence of that, sir, would be to avoidt he contract, and that's not a solution for any producer.

QUESTION: Why would that void the contract?

MR. DAVIDSON: Because what that would do is say that a fundamental premise of the contract was now gone, that certain kinds of gas were no longer in a category which the government now says it must be considered to be in.

I don't believe that would obligate anybody to pay a different price. I think what it would do is void the deal. And that's not really a remedy for the producers.

QUESTION: Mr. Davidson, could I ask you about the central point of your argument, which -- you diverge from

FERC in that you want to interpret 101(b)(5) more concretely than they do. They want to decide the phrase, the provision which could result in the highest price. They want to do it in the abstract. Obviously unregulated could produce a higher price than regulated. You want to do it more concretely. You want to look at the particular contract.

But if you are going to get more concrete, isn't it true that every contract is amendable by agreement of the parties, so even if you look at it in a concrete fashion, and look at this particular contract between the parties, that particular contract could result in the higher price because the parties could always get together and modify the price provision, and indeed a lot of them are doing it these days, aren't they --

MR. DAVIDSON: Absolutely.

QUESTION: -- in view of the whole debaucle that has occurred because of the --

MR. DAVIDSON: Absolutely. There is a tremendous amount of renegotiation going on.

QUESTION: So on any interpretation I don't see how you could say, whether you do it concretely or abstractly, that anything but the deregulated price could result in the highest.

MR. DAVIDSON: Remember that the way it really works in the real world is that what the parties do is, at the end of every month they total up how much gas was purchased the prior month, and they look at their contract and say, okay, what do you have to pay for it? Now, for that given month there was a contract, there were contract provisions that were in effect, and the parties just have to determine what the appropriate price is from their in effect contract provisions.

We don't believe that Congress was concerned with the hypothetical possibilities of what could be true in the future under different market conditions or under different contract provisions, for that matter, in the case of your example. We think that what Congress said was that when you had gas that was classified in more than one category, the price that is to be applied is the price that the parties apply as a matter of course in their contracts, which are in effect for a given time period, when they compute what the price for that gas purchased during that time period should be.

QUESTION: Mr. Davidson, may I interrupt you? You used the words "contract provisions." You do that in your brief two or three times. The statutory word "provision," "the provision which could result in the highest price," would you not agree with me that the word "provision" means the statutory provision which could result in the higher price?

MR. DAVIDSON: Yes. Yes.

QUESTION: Okay.

MR. DAVIDSON: There is no question about that. That does refer to the statutory provision which places an NGPA category label on the gas which the parties then take back to their contract for the purposes of determining what the contract price will be.

With that general background, I'd like to address what we do believe to be the central legal issue in the case, which is just that Order 406 is inconsistent with the language of Section 101(b)(5) of the statute as well as the conference committee materials. Our position is that Order 406 is inconsistent with the plain meaning of Section 101(b)(5).

I recognize that FERC also argues that the language of Section 101(b)(5) plainly supports their position. But merely because a party utters the words "plain meaning" doesn't make it true. A plain meaning argument, like any other, is fairly subject to examination, and for that reason I think it is helpful to compare the plain meaning arguments, the two of them being advanced in this case. On the one -- so

QUESTION: If it's a standoff, you lose. I mean, you are the one that has to establish the plain meaning. They don't. They just have to establish a meaning that's in the ballpark, that justifies FERC in interpreting it that way.

QUESTION: Assuming that the Congressional intent can also not be determined from the legislative history, but we believe that the language, the interpretation which FERC has adopted is inconsistent not only with the language, but also with the materials in the conference report.

Our plain meaning argument is simply stated. The plain meaning of language is the meaning one first and naturally attaches to it when one sees it or hears it. As the unanimous Court of Appeals held, the plain and ordinary meaning of the relevant language of Section 101(b)(5) that if any natural gas qualifies under more than one provision, the provision which could result in the highest price is, the producer gets the highest price.

Moreover, if that was the thought that one wanted to convey, this is how you would write it, or perhaps something very close to it. If on the other hand the thought one wanted to convey was that if gas qualified for at least one NGPA category, which is deregulated, it shall be deemed deregulated, this probably isn't the way that you'd write it.

And that in a nutshell is our plain meaning argument.

Now, FERC has a different problem, and that is illustrated no better than on Page 2 of its opening brief, where Section 101(b)(5) and Order 406 are laid out right next to each other for easy comparison. The fact is that when you just read these two sentences, the interpretation that FERC is adopted in Rule 406 just doesn't leap out at you in the statute.

Indeed, when you read those two sentences, they just seem inconsistent, and for that reason FERC's plain meaning argument is different in character than respondent's, and oddly enough, for an argument of this type, it keeps changing.

FERC has suggested at least three plain understandings of this statute in the course of these proceedings, and of course we know that Mr. Solomon has advanced yet another one. In its current iteration, FERC's argument about the language of Section 101(b)(5) goes on for almost seven full pages, parses through that one sentence in great detail, several individual words and phrases are expanded into full explanatory paragraphs.

There are references to other NGPA provisions. There are references to FERC's view of the overall structure and approach of the statute, and even to bits of legislative history. That argument gets so complex and involved that whatever else one wants to say about it, it just isn't a plain meaning argument.

The natural reading of this statute is the one that the Court of Appeals adopted. Moreover, the Court of Appeals' reading of the statute is supported by the conference committee materials. First, the House conferees stated when discussing Section 101(b)(5) in their explanation statement that a producer was entitled to qualify his gas in whatever NGPA category which yielded the highest price to him, which necessarily requires the producer to go back to his contract to see which NGPA category accomplishes that result.

Now, there is no logic in then coming along later and telling the producer, forget about the relative price levels in your actual contract that you looked at originally because what you -- the way you are really going to be paid is according to the abstract notion of whether or not the NGPA category has a price ceiling, and if it does, which price ceiling is higher, as the government argues.

QUESTION: Mr. Davidson, if we think that the language in the statute is capable of being read as the government would have us read it, do you then lose because of the difference that is owed to the agency interpretation?

MR. DAVIDSON: First of all, this is not an agency deference case in our view because the intent of Congress can be determined not only from the language but also in addition from the conference materials, one of which example I just gave and another key one which I will come to in a moment.

But moreover, it is not an agency -- the government doesn't even win on an agency deference standard because it is not a permissible reading of the statute and does not satisfy certain purposes of Congress when it passed the NGPA. For example, the purposes that these special categories of incentive priced gas were entitled to incentive prices pursuant to Sections 107(c)(5) and Section 108.

Similarly, FERC's order has the practical effect of depriving the producers of actual contract prices they negotiated in their contracts, and that is certainly inconsistent with at least the spirit of Section 101(b)(9), which says that nothing in the NGPA's maximum lawful price provisions or a ceiling price or deregulation should operate to nullify or supersede a contract price.

The second piece of the legislative history which we think is key is the conference report itself, which is intended to be the definitive explanatory statement of the NGPA, and was probably crafted as carefully as the statute itself.

Page 83 of the conference report states that upon deregulation, wells qualified in both the Section 108 stripper well category as well as the Section 105 intrastate category, gas from those kinds of wells could be sold under the regulated provisions of Section 108 rather than taking deregulated treatment as Section 105 gas.

Now, FERC has tried to avoid this part of the conference report by arguing that it was addressed to a particular question not directly involved in this case, and in its reply brief by trying to make the whole thing look as complicated as possible.

I think the simplest response to FERC's argument is that the nature and complexity of the question addressed on Page 83 of the conference report really doesn't matter here. Whatever the question was, the answer that the conference report gave says clearly, and clearly expresses the understanding that dually qualified 108 and 105 gas could be sold as regulated 108 stripper gas as opposed to deregulated intrastate Section 105 gas, and FERC's order does exactly the opposite. FERC's order mandates that gas which is so duly qualified must be sold as deregulated Section 105 gas rather than as regulated Section 108 gas.

QUESTION: You disagree with the government's statement that FERC could have achieved this by simply altering its regulations to say you can't put something in this one category without putting it in the other ones?

MR. DAVIDSON: Sir, that argument does not apply to the 108 category. Their particular argument in that regard applies to their effort to say that 107(c)(5) gas --

QUESTION: Right.

MR. DAVIDSON: -- which they have the right to define shall be deemed 102 gas.

QUESTION: Why can they do it in the one situation and not in the other.

MR. DAVIDSON: Because Congress defined what Section 108 stripper well gas was in the statute but left in Section 107(c)(5) the Commission the authority to define --

QUESTION: I see.

MR. DAVIDSON: -- what Section 107(c)(5) gas is, so there is a distinct difference there.

On that precise point, I think it's important that the government really is arguing that it doesn't make any difference in the case of the 107(c)(5) gas because they have the right to redefine that gas. The fact is, they have not done that and have no proper record for doing that as they themselves -- as FERC itself conceded in Order 459, issued not just four months ago.

In that order, FERC expressly refused to rescind or modify its original Order 99, which defined what high cost and risk gas was, and said that it met the Congressional standard for being produced under such conditions of extraordinary risks or costs that it was entitled to the Congressional incentive prices that Congress imagined -- envisioned in the statute.

For FERC to now argue in light of that order that it has in effect done that redefinition, after just refusing to do that in December, and the reaso that it gave in December was that it did not even at that point have a proper record on which to base such a determination, for them to now argue that it is in effect accompslishing that same result merely highlights the improper nature of and lack of support for that part of Order 406.

In conclusion I would like to refer to or discuss or mention the effect and rationale of Order 406, what they really are from the point of view of a producer, like my client, Martin Exploration.

As of March 31st, 1984, Martin had drilled and properly qualified high cost and risk Section 107 wells and had done so in reliance upon contract prices it negotiated with pipelines.

CHIEF JUSTICE REHNQUIST: Your time has expired, Mr. Davidson. Thank you.

Mr. Taranto, you have two minutes remaining.

ORAL ARGUMENT OF RICHARD G. TARANTO, ESQUIRE

ON BEHALF OF THE PETITIONER IN

NO. 87-363 - REBUTTAL

MR. TARANTO: If I could just make one point, the problem in this case arises solely because producers contracted to renegotiate upon deregulation. If they had set a fixed price for a particular quantity of gas regardless of whether it was regulated or deregulated, then this case would not have arisen.

The producers here have argued that there is a statutory glitch that entitles them to opt out of those deregulation clauses and collect higher prices under the regulatory ceilings. Our position, simply stated, is that there is no glitch. Producers must live by the deregulation clauses and take the lower prices.

Thank you.

CHIEF JUSTICE REHNQUIST: Thank you, Mr. Taranto. The case is submitted.

(Whereupon, at 10:59 a.m., the case in the above-entitled matter was submitted.)

REPORTERS' CERTIFICATE

DOCKET NUMBER: 87-363 and 87-364

CASE TITLE: FERC v. Martin and PSC of New York v. Martin

HEARING DATE: March 28, 1988

LOCATION: Washington, D.C.

I hereby certify that the proceedings and evidence are contained fully and accurately on the tapes and notes reported by me at the hearing in the above case before the U.S. Supreme Court.

Date: 4/1/88

Margaret Daly
Official Reporter

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