

# BUY/SELL TRANSACTIONS IN THE NATURAL GAS INDUSTRY: WHAT'S PROHIBITED AND WHAT ISN'T?

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## I. INTRODUCTION

The most recent chapter in the Federal Energy Regulatory Commission's (FERC or Commission) restructuring of the natural gas industry occurred in its Order 636 series.<sup>1</sup> Among other things, Order 636 requires interstate natural gas pipelines to unbundle natural gas transportation service and establishes uniform procedures for the allocation of firm pipeline capacity in both the primary and secondary markets.<sup>2</sup> The uniform scheme of pipeline capacity allocation in the secondary market is known as capacity release.

In a pair of orders issued simultaneously with Order 636, the Commission prohibited the continued use of "buy/sell" transactions,<sup>3</sup> which effectively allow a shipper holding capacity rights on an interstate pipeline to transfer those rights to another party through a purchase and resale transaction. This type of purchase and resale transaction allows the shipper holding the firm capacity rights on the interstate pipeline to use its transportation rights to benefit a specific customer without an actual assignment of pipeline capacity. This type of transaction, where the shipper retains title to the gas and utilizes its own capacity rights, albeit for the benefit of another party, is distinguished from the release of pipeline capacity under the procedures adopted by Order 636. Under capacity release procedures, the right to capacity is released by a shipper for purchase by another shipper in the secondary market.

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1. Order No. 636, *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, III F.E.R.C. STATS. & REGS. ¶ 30,939, 57 Fed. Reg. 13,267 (1992) (to be codified at 18 C.F.R. pt. 284), *order on reh'g*, Order No. 636-A, III F.E.R.C. STATS. & REGS. ¶ 30,950, 57 Fed. Reg. 36,128, *order denying reh'g and clarifying*, Order No. 636-B, 61 F.E.R.C. ¶ 61,272, 57 Fed. Reg. 57,911 (1992), *order denying reh'g*, 62 F.E.R.C. ¶ 61,007 (1993). See generally 3 DAVID J. MUCHOW & WILLIAM A. MOGEL, *ENERGY LAW & TRANSACTIONS* § 83.02[14] (1994); Donald F. Santa, Jr. & Patricia J. Beneke, *Federal Natural Gas Policy and The Energy Policy Act of 1992*, 14 ENERGY L.J. 1, 7-8, 18-19 (1993).

2. *Id.* See also 18 C.F.R. §§ 284.242-.243 (1993).

3. See *El Paso Natural Gas Co.*, 59 F.E.R.C. ¶ 61,031 (1992), *reh'g denied*, 60 F.E.R.C. ¶ 61,117 (1992), *order denying motion*, 61 F.E.R.C. ¶ 61,087 (1992), *appeal pending*, *United Distribution Co's. v. FERC*, No. 92-1485 (D.C. Cir.). See also *Algonquin Gas Transmission Co.*, 59 F.E.R.C. ¶ 61,032 (1992), *reh'g denied*, 60 F.E.R.C. ¶ 61,113 (1992), *appeal pending*, *Associated Gas Distribs. v. FERC*, No. 92-1496 (D.C. Cir.).

As part of its transition to the new uniform scheme of capacity allocation embodied in the capacity release procedures established by Order 636, the FERC grandfathered certain then-existing and transitional "buy/sell" agreements and prohibited future "buy/sell" agreements.<sup>4</sup> The Commission's clear rationale was to phase out "buy/sell" agreements and to ensure nondiscriminatory capacity allocation in the secondary market by requiring that such allocation occur under the newly-established capacity release procedures.<sup>5</sup>

This article addresses the Commission's policy of prohibiting non-grandfathered "buy/sell" arrangements. Initially, the Commission's orders on this subject appear clear. However, implementation of FERC's policy on this subject has been less than clear. As a result of various interpretations of FERC's pronouncements, there is no clear understanding among industry participants as to where the lines of permitted "buy/sell" arrangements occur. Since lack of clarity in FERC's policies in this area has produced differing interpretations, and therefore different degrees of compliance with FERC's policies, this article attempts to present one interpretation for public scrutiny so as to focus the industry and the Commission on the problem. As discussed in this article, FERC's prohibition against nongrandfathered "buy/sell" transactions applies to those non-grandfathered purchase/resale transactions that involve any firm interstate pipeline capacity holder and any seller/repurchaser of gas, rather than those purchase/resale transactions that involve only local distribution companies and the end-users they serve.

## II. DISCUSSION

### A. *Obtaining Unbundled Capacity Rights on an Interstate Pipeline*

Rights to unbundled interstate pipeline transportation capacity are requested directly from the interstate pipeline.<sup>6</sup> On most pipelines, all available capacity is posted on the pipeline's Electronic Bulletin Board (EBB), whether the capacity is uncommitted to any shipper or released by a shipper to the pipeline for sale under the pipeline's capacity release procedures.<sup>7</sup>

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4. See sources cited *supra* note 3.

5. See 59 F.E.R.C. ¶ 61,032, at 61,095.

6. See, e.g., *Valero Interstate Transmission Co.*, 62 F.E.R.C. ¶ 61,197, at 62,392-93 (1993), *reh'g denied*, 65 F.E.R.C. ¶ 61,171 (1993); See also Order No. 636, III F.E.R.C. STATS. & REGS. ¶ 30,939, at 30,420-21, 57 Fed. Reg. 13,267 (1992); Order No. 636-A, III F.E.R.C. STATS. & REGS. ¶ 30,950, at 30,556, 57 Fed. Reg. 36,128 (1992); *Algonquin Gas Transmission Co.*, 63 F.E.R.C. ¶ 61,188, at 62,324 (1993), *on reh'g*, 64 F.E.R.C. ¶ 61,208 (1993); *ANR Pipeline Co.*, 62 F.E.R.C. ¶ 61,079, at 61,528 (1993), *reh'g granted in part, denied in part*, 64 F.E.R.C. ¶ 61,140, *on reh'g*, 65 F.E.R.C. ¶ 61,162 (1993); *Arkla Energy Resources*, 62 F.E.R.C. ¶ 61,076, at 61,448-449 (1993), *on reh'g*, 63 F.E.R.C. ¶ 61,029 (1993), *reh'g granted in part, denied in part*, 64 F.E.R.C. ¶ 61,166 (1993).

7. See, e.g., *Black Marlin Pipeline Co.*, 63 F.E.R.C. ¶ 61,162, at 62,093 (1993); *Phillips Gas Pipe Line Co.*, 62 F.E.R.C. ¶ 61,194, at 62,353 (1993); *Williston-Basin Interstate Pipeline Co.*, 62 F.E.R.C. ¶ 61,144, at 62,024 (1993), *on reh'g*, 63 F.E.R.C. ¶ 61,184 (1993), *on reh'g*, 64 F.E.R.C. ¶ 61,297 (1993); *Caprock Pipeline Co.*, 62 F.E.R.C. ¶ 61,088, at 61,630 (1993); *El Paso Natural Gas Co.*, 61 F.E.R.C. ¶ 61,333, at 62,305 (1992), *reh'g denied*, 62 F.E.R.C. ¶ 61,311 (1993), *reh'g granted in part and denied in*

Uncommitted capacity is subject to the pipeline's queuing procedures and other tariff requirements.<sup>8</sup> Released capacity is subject to any conditions on the release imposed by the releasing shipper and to the pipeline's tariff requirements.<sup>9</sup> Thus, unbundled transportation capacity rights are obtained from the pipeline through either the purchase of uncommitted pipeline capacity (the primary market for capacity rights) or pipeline capacity released by an existing shipper for competitive bidding (the secondary market for capacity rights).<sup>10</sup>

There are numerous rules, tariff requirements, and policies that relate to obtaining pipeline capacity on any pipeline system. As a practical matter, the pipeline's effective FERC-approved gas tariff provides the detailed requirements that need to be met.

### *B. Use of Pipeline Capacity Rights by a Shipper Holding Those Rights*

A shipper holding pipeline capacity rights has several options for using and/or marketing those rights. Firm and interruptible capacity rights need to be distinguished since some alternatives apply to one and not the other.

#### 1. Release of Pipeline Capacity

A shipper with firm capacity rights on an interstate pipeline may release those rights under the pipeline's capacity release procedure.<sup>11</sup> Under this procedure, the capacity rights, if purchased by a replacement shipper, may be used by the replacement shipper to move its gas to the pipeline delivery points. Interruptible capacity rights are not covered by the FERC's capacity release procedures.<sup>12</sup>

FERC's policy of allowing flexible delivery points is not discussed here, nor are the details of FERC's capacity release program.<sup>13</sup> Note, however, that (1) a shipper may sell its firm capacity to a prearranged replacement shipper for less than one calendar month without being subject to the competitive bidding requirements generally applicable to capacity release transactions;<sup>14</sup> (2) a prearranged replacement shipper at the maximum rate

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part, 64 F.E.R.C. ¶ 61,265 (1993), *reh'g granted in part and denied in part*, 65 F.E.R.C. ¶ 61,134 (1993), *reh'g denied and clarification granted in part and denied in part*, 66 F.E.R.C. ¶ 61,183 (1994). See 18 C.F.R. § 284.8(b)(3)-(4) (1993). See also 18 C.F.R. § 284.243(d) (1993).

8. See, e.g., *El Paso Natural Gas Co.*, 62 F.E.R.C. ¶ 61,311 (1993), *reh'g granted in part and denied in part*, 63 F.E.R.C. ¶ 61,169 (1993); *Williston-Basin*, 62 F.E.R.C. ¶ 61,144, at 62,024-25.

9. See, e.g., *Transwestern Pipeline Co.*, 63 F.E.R.C. ¶ 61,138, at 61,911 (1993); 62 F.E.R.C. ¶ 61,194, at 62,353; *Southern Natural Gas Co.*, 62 F.E.R.C. ¶ 61,136, at 61,957 (1993), *reh'g granted in part and denied in part*, 64 F.E.R.C. ¶ 61,274 (1993).

10. See Order No. 636-A, III F.E.R.C. STATS. & REGS. ¶ 30,950, at 30,552, 57 Fed. Reg. 36,128 (1992) [hereinafter Order No. 636-A] (stating "The Commission believes it is desirable for efficiency and administrative reasons for all [capacity] allocations to be effected through the pipeline to avoid the possibility of discriminatory allocations").

11. 18 C.F.R. § 284.243 (1993).

12. 18 C.F.R. § 284.243(a) (1993).

13. See 18 C.F.R. §§ 284.221(h), 284.243 (1993).

14. 18 C.F.R. § 284.243(h); Order No. 636, III F.E.R.C. STATS. & REGS. ¶ 30,939, 57 Fed. Reg. 13,267 (1992); *order on reh'g*, Order No. 636-A, III F.E.R.C. STATS. & REGS. ¶ 30,950, 57 Fed. Reg.

(or a prearranged shipper willing to match the best offer submitted by another shipper) and meeting other terms and conditions of the release will receive the capacity;<sup>15</sup> (3) firm capacity may be sold subject to a right of recall;<sup>16</sup> and (4) capacity may be released subject to nondiscriminatory conditions imposed by the releasing shipper.<sup>17</sup>

## 2. Transportation of Shipper-Owned Gas for Sale Downstream of the Transportation by the Interstate Pipeline

A shipper may use its pipeline capacity rights, firm or interruptible, to move gas to which it has title to a primary or secondary delivery point.<sup>18</sup> Under this type of arrangement, the shipper would be shipping gas purchased upstream of or at the receipt point on the pipeline.<sup>19</sup> The shipper's sale at the downstream end of the transportation by the interstate pipeline is permissible under FERC transportation policies *unless* it constitutes the downstream portion of a prohibited "buy/sell" transaction.<sup>20</sup> The definition of prohibited "buy/sell" transactions is discussed in section II.C.<sup>21</sup>

## 3. Grandfathered Transactions Under Pre-Order 636 Capacity Brokering, Release, and Assignment Certificates

Prior to Order 636, certain pipelines<sup>22</sup> were authorized to conduct capacity brokering, capacity release, and capacity assignment transactions under Natural Gas Act certificates of public convenience and necessity. In a companion order to Order 636, the FERC modified these programs by requiring the authorized pipelines to merge their prior authorization into revised tariff sheets that comply with the capacity release program promulgated by Order 636.<sup>23</sup> Existing arrangements made under these pre-Order 636 certificates, as well as arrangements made prior to the effectiveness of the pipeline's capacity release tariff sheets, were allowed to continue through their term. These arrangements were subject to posting on the pipeline's EBB for informational purposes and the execution of a contract

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36,128 (1992); *order on reh'g and clarification*, Order No. 636-B, 61 F.E.R.C. ¶ 61,272, at 61,994, 57 Fed. Reg. 57,911 (1992), *reh'g denied*, 62 F.E.R.C. ¶ 61,007 (1993).

15. Order No. 636-B, 61 F.E.R.C. ¶ 61,272, at 61,994-95, 61,997, 57 Fed. Reg. 57,911 (1992) [hereinafter Order No. 636-B].

16. Order No. 636, III F.E.R.C. STATS. & REGS. ¶ 30,939, at 30,558, 57 Fed. Reg. 13,267 (1992) [hereinafter Order No. 636].

17. See 18 C.F.R. § 284.243(e) (1993).

18. Interstate transportation would require that the transporter have authorization to provide the service either under section 7(c) of the Natural Gas Act, 15 U.S.C.A. § 717f(c) (West Supp. 1994), or section 311 of the Natural Gas Policy Act, 15 U.S.C.A. § 3371 (West Supp. 1994).

19. "Downstream" means towards the city-gate or burner tip where the gas is consumed. "Upstream" means towards the production source or where the gas is received by the pipeline.

20. The focus here is on FERC transportation policies. Presumably, the sale would either be a direct sale or covered by blanket marketer authority under 18 C.F.R. § 284.402 (1993).

21. See *infra* text and accompanying notes 24-50.

22. See *Algonquin Gas Transmission Co.*, 59 F.E.R.C. ¶ 61,032, at 61,096-97 (1992), *on reh'g*, 60 F.E.R.C. ¶ 61,113 (1992) (listing authorized pipelines).

23. *Id.*

between the pipeline and assignee once the pipeline's capacity release procedures became effective.<sup>24</sup>

#### 4. "Buy/Sell" Transactions

Certain transactions, called "buy/sell" transactions, are prohibited if the contract providing for the "buy/sell" arrangement was executed after the effectiveness of a pipeline's capacity release procedures.<sup>25</sup> Contracts executed *before* the effectiveness of a pipeline's capacity release procedures are grandfathered and permitted to continue after that date through their term, as well as through any evergreen period.<sup>26</sup> Such grandfathered "buy/sell" arrangements had to be posted on a pipeline's EBB once the capacity release procedures became effective.

#### C. What is a Prohibited Buy/Sell Transaction?

The FERC has not been entirely clear in defining "buy/sell" transactions. As a consequence, the extent of FERC's prohibition against non-grandfathered "buy/sell" transactions has been interpreted differently by industry participants.

The criteria from older cases which approved "buy/sell" arrangements as a method of foreclosing capacity brokering are discussed in *El Paso Natural Gas Co. (El Paso)*.<sup>27</sup> The principal requirements were (1) title to gas by the capacity holder both at the time the gas is delivered to the pipeline for transportation and while the gas is being transported by the pipeline;<sup>28</sup> and (2) the purchase and resale

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24. *Id.* at 61,096. See also Order No. 636, *supra* note 16, at 31,416.

25. See 59 F.E.R.C. ¶ 61,031, at 61,080; Order No. 636, *supra* note 16, at 30,416-17 (ordering "buy/sell deals executed between the date of this order and the date the pipeline's capacity releasing mechanism goes into effect can continue if the firm capacity holder does not give up its capacity in the restructuring proceeding. . . . After a pipeline's capacity releasing mechanism goes into effect, no new buy/sell deals may be executed after that date and thereafter all allocations of interstate capacity must be done under the capacity releasing mechanism"), *on reh'g.*, Order No. 636-A, *supra* note 10, at 30,550.

26. Order No. 636-A, *supra* note 10, at 30,552.

27. 59 F.E.R.C. ¶ 61,031, at 61,079-80 (1990). The Commission's discussion relies principally upon its prior decision in *Texas Eastern Transmission Corp.*, 37 F.E.R.C. ¶ 61,260, at 61,684-85 (1987) [hereinafter *Texas Eastern*], *overruled by* Order No. 636, *supra* note 16.

28. The title requirement was adopted to protect the integrity of the first-come, first-served principle and to prevent capacity brokering by firm pipeline sales customers, which were given a nontransaction-specific transportation priority in connection with their bundled sales rights. See 37 F.E.R.C. ¶ 61,260, at 61,684-85 (reasoning "the proper way to ensure that the firm sales customers do not use their non-transaction specific priority to Texas Eastern's capacity to engage in capacity brokering is to require that all shippers have title to the gas at the time the gas is delivered to Texas Eastern for transportation and while the gas is being transported by Texas Eastern"). See also, 59 F.E.R.C. ¶ 61,031, at 61,079. This title requirement contemplated that the "firm sales customer may use its priority to the pipeline's capacity to act as an agent, or broker, of gas" by purchasing the gas for a specific customer. *Id.* (quoting *Texas Eastern*). This requirement that "shippers hold title to the gas transported on interstate pipelines utilizing their transportation priority" has been replaced by the requirement that "the shippers hold title to the gas." *Id.* at 61,080 (holding "a replacement shipper may transport its own gas, utilizing capacity rights previously reserved to another shipper, without the original shipper's losing its transportation priority rights") (emphasis added).

of gas by the capacity holder for a specific customer of the capacity holder.<sup>29</sup>

The transactions addressed by the Commission in *El Paso* involve the purchase of gas by a Local Distribution Company (LDC) from an end-user or a producer designated by an end-user, transportation of the gas through an interstate pipeline using the LDC's capacity rights, and the sale by the LDC to the end-user at the LDC's delivery point.<sup>30</sup> The Commission's description of "buy/sell" arrangements in Order 636 also refers to the purchase of gas "from an end-user or a merchant designated by an end-user" and resale "to the end-user at the retail delivery point."<sup>31</sup> These types of transactions would appear to be clearly considered "buy/sell" transactions by the Commission.<sup>32</sup>

However, the prohibition appears to extend beyond purchase/resale transactions involving LDC holders of capacity. FERC Order 636-B found the prohibition against nongrandfathered "buy/sell" transactions to apply to all firm capacity holders, thus making it immaterial whether the firm capacity holder is an LDC.<sup>33</sup>

Furthermore, FERC's orders suggest a broad prohibition that would apply regardless of the entity selling to and then repurchasing from the firm capacity holder.<sup>34</sup> It would seem immaterial to achieve the Commission's stated objective of establishing a uniform and nondiscriminatory scheme of firm capacity allocation subject to federal control whether the seller/repurchaser of gas is an end user or another type of entity, such as a producer or marketer.<sup>35</sup> In articulating this objective in *El Paso*, the Commission states:

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29. See 59 F.E.R.C. ¶ 61,031, at 61,079 (citing *Texas Eastern*). The purchase and resale of gas had a transaction-specific element, i.e., it was a purchase/resale involving a specific customer of the capacity holder. The capacity rights of the shipper participating in the "buy/sell" transaction did not have a transaction-specific nature, an exception to the general transportation requirement at that time. This transaction-specific transportation requirement was adopted "to prevent shippers from brokering capacity and abusing the first-come, first-served principle [of capacity allocation]." *El Paso Natural Gas Co.*, 35 F.E.R.C. ¶ 61,440, at 62,065 (1986), *overruled by* Order No. 636, *supra* note 16, at 30,420; 37 F.E.R.C. ¶ 61,260, at 61,684 (1987), *overruled by* Order No. 636, *supra* note 16, at 30,420.

30. 59 F.E.R.C. ¶ 61,031, at 61,076. See also Order No. 636-B, *supra* note 15, at 62,002 (1992) (citing *El Paso Natural Gas Co.*, 59 F.E.R.C. ¶ 61,031 (1992)).

31. See Order No. 636, III F.E.R.C. STATS. & REGS. ¶ 30,939, at 30,416, 57 Fed. Reg. 13,267 (1992), *on reh'g*, Order No. 636-A, III F.E.R.C. STATS. & REGS. ¶ 30,950, at 30,550, 57 Fed. Reg. 36,128 (1992), *on reh'g*, Order No. 636-B, 61 F.E.R.C. ¶ 61,272, at 62,002, 57 Fed. Reg. 57,911 (1992).

32. 59 F.E.R.C. ¶ 61,031, at 61,076. "Among the common features of all 'buy/sell' transactions are that to effectuate delivery of natural gas to designated customers an LDC holds title to gas specifically purchased by the LDC for the customer while utilizing its firm capacity rights to transport the designated gas over the interstate pipeline. Any transactions having these characteristics would be 'buy/sell' transactions. . . ." 60 F.E.R.C. ¶ 61,117, at 61,386.

33. Order No. 636-B, *supra* note 15, at 62,002.

34. See 59 F.E.R.C. ¶ 61,031, at 61,080; Order No. 636, *supra* note 16, at 30,416.

35. See 59 F.E.R.C. ¶ 61,031, at 61,080.

The capacity release program is but one of a number of integrally related regulatory initiatives in Order No. 636 designed to place all natural gas sellers on an equal footing. The capacity release mechanism required under Order No. 636 requires that capacity be released to the open market, in which all potential shippers have an equal chance to bid for released space. In *Algonquin Gas Transmission Co. et al.*, another companion order to Order No. 636, we stated our belief that this goal can only be accomplished if all capacity reallocations are undertaken on the same general basis on all pipelines. . . . [O]nly by mandating generally uniform national capacity reallocation mechanisms can the Commission prevent any pipeline or firm shipper from achieving an undue advantage or incurring an undue disadvantage compared to firm shippers on other pipelines. . . .<sup>36</sup>

On the basis of the Commission's orders, prohibited "buy/sell" transactions appear to include the purchase and resale of gas by any firm capacity holder where the gas is purchased at or upstream of the interstate pipeline receipt point and resold back to the upstream seller at or downstream of the pipeline delivery point.<sup>37</sup> Thus, firm capacity held by any type of shipper, including marketers and producers, would seem to be subject to the prohibition,<sup>38</sup> and gas sold and repurchased by all types of entities would seem to be included.<sup>39</sup> Arguably, the policy excludes purchase/resale transactions involving interruptible capacity, notwithstanding the broad language of Order 636-B, based upon the Commission's goals and the scope of the uniform capacity release procedures established in Order 636, which applies to the release of firm capacity only.

Subsequent pronouncements by the FERC and by the Chair of the Commission have provided an interpretation of FERC orders that is more limited. This has caused both uncertainty as to the scope of the Commission's prohibition against non-grandfathered "buy/sell" transactions and the very type of undue advantages in capacity allocation that FERC orders sought to prevent.

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36. *Id.*

37. Use of agents or designated parties, such as where a producer is designated by the downstream repurchaser to sell gas to the capacity holder, would seem to be equally covered by the prohibition. *See, e.g.*, 59 F.E.R.C. ¶ 61,031, at 61,076-77. Purchase/resale transactions that are not transaction-specific, *e.g.*, where the resale is part of the capacity holder's "system-supply," would appear to be excluded from the definition of a prohibited "buy/sell" transaction. *Id.* However, the definition of "system-supply" in this context is not entirely clear. Traditional system-supply of LDCs would appear to be clearly excluded from the prohibition, but less clear is the aggregated supply of marketers and producers. Furthermore, it is unclear whether non-traditional "system-supply" arrangements of LDCs, such as bifurcated system-supply, would be excluded from the prohibition. *See, e.g.*, the separate Purchase Gas Adjustment (PGA) structure discussed in *Great Lakes Gas Transmission Co.*, 40 F.E.R.C. ¶ 61,044 (1987) (ordering the pipeline to show cause why separation of PGA by customer or customer group was not unduly discriminatory), *order terminating proceeding*, 41 F.E.R.C. ¶ 61,292 (1987) (terminating show cause proceeding without finding on discrimination issue).

38. *See* Order No. 636-B, *supra* note 15, at 62,002.

39. This is a significant point of clarification since there appears to be on-going arrangements that have the characteristics of prohibited "buy/sell" transactions where the seller/repurchaser is an entity other than an end-user. Examples of this include arrangements involving the purchase of gas by an LDC that utilizes its firm pipeline capacity to take delivery of gas, and subsequently resells the same quantity of gas back to a nonend-user seller/repurchaser in an off-system sale under authority of 18 C.F.R. § 284.402 (1992).

To date, there have been two public pronouncements that have contributed to this uncertainty. One is a letter from the Chair of the Commission to Congressman Dingell, the other is the FERC's brief in the District of Columbia Court of Appeals in the court review of the orders issued in *El Paso*.

The March 16, 1993, letter (Letter) from Chair Moler to Congressman Dingell on FERC's implementation of Order 636 provides an interpretation of what constitutes a "buy/sell" transaction (an interpretation that is narrower than the definitions provided in Order 636<sup>40</sup> and in *El Paso*). While not a FERC order, the Letter reflects both the interpretation of the Chair of FERC's newly-issued regulations and representations made by the Chair to a member of Congress, and thus provides an informal interpretation of the Commission's policy.<sup>41</sup> In the Letter, the following definition of buy/sell transactions is provided:

*Question No. 5a:* Please provide a definition of the "buy/sell" transactions the Commission intends to prohibit.

*Answer:* As defined in Order No. 636 (at page 71), a "buy/sell" transaction is one involving the following two stages. First, a capacity holder purchases gas in the production area from an end user or a gas merchant designated by an end user. Second, the capacity holder ships the gas on its own firm capacity and sells the gas to the end user at the retail delivery point. The Commission is requiring the eventual prohibition of all transactions having this fundamen-

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40. Order No. 636, *supra* note 16.

41. The Letter, while providing a definition of prohibited "buy/sell" transactions, is not an official Commission decision and does not bind the Commission. See Department of Energy Organization Act, Pub. L. No. 95-91, § 401(e), 91 Stat. 582 (1977) (creating tit. IV, Federal Energy Regulatory Commission ¶ 1061, § 401(e), and stating "The Chairman . . . shall preside at all sessions of the Commission and a quorum for the transaction of business shall consist of at least three members present. Each member of the Commission, including the Chairman, shall have one vote. Actions of the Commission shall be determined by a majority vote of the members present"). The precedential effect of the Chair's Letter is analogous to an interpretation provided by FERC's general counsel in an opinion letter. See Order No. 376, *Clarification of the Rules of Practice and Procedure; Establishment of Final Rule on NGPA Interpretations*, 1982-1985 F.E.R.C. STATS. & REGS. ¶ 30,568, 49 Fed. Reg. 21,704 (1984) (holding "interpretations from the Commission's General Counsel construing the NGPA or Commission rules or orders are not binding on the Commission so that the Commission is unprepared to provide by rule . . . that reliance on an interpretation will immunize a person from civil or criminal liability if the Commission revises or modifies the interpretation"). See also KENNETH DAVIS, ADMINISTRATIVE LAW § 4.09, at 79 (1959 & Supp. 1970) (stating that a major disadvantage of the advisory opinion is lack of binding effect). For various cases involving the precedential effect of opinion letters, see *Diebold v. United States*, 947 F.2d 787, 804 n.11 (6th Cir. 1991) (stating that Comptroller General opinions, in this case a letter responding to a Senatorial inquiry, have no precedential effect); *Apex Oil Co. v. DiMauro*, 110 F.R.D. 490, 495 (S.D.N.Y. 1985) (holding that statements in an interpretive letter from the general counsel of a Commission interpreting a statute were not binding). *E.g.*, *New York City Employees Retirement Sys. v. Dole Food Co.*, 795 F. Supp. 95, 100-01 (S.D.N.Y. 1992) (while giving due deference to an SEC staff opinion letter, the court did not follow its definition of a regulation's term); *C.I.R. v. Keystone Consol. Indus., Inc.*, 113 S. Ct. 2006, 2011 (1993) (stating that the Department of Labor's views, in an advisory opinion of a statute that it administers, had no precedential effect and that the views of the Commissioner of the Internal Revenue Service were not entitled to deference in interpreting a statute because they had not been set out in a formal regulation). See generally *Federal Hous. Admin. v. Darlington, Inc.*, 358 U.S. 84 (1958), *reh'g denied*, 358 U.S. 397 (1959) (holding that an agency's letter to its field offices interpreting a statute constituted evidence relevant to construction of the statute).

tal feature. It is the Commission's view that these "buy/sell" transactions are inconsistent with the capacity release provisions that the Commission established in Order No. 636 for allocating capacity on interstate pipelines. If allowed to continue after pipelines restructure by unbundling sales and transportation, "buy/sell" transactions could undermine open access transportation by circumventing the conditions that the Commission has established to protect against undue discrimination.

In essence, the LDC or other firm capacity holder is using its priority to interstate pipeline capacity to act as an agent or broker of an end-use customer to effect deliveries of gas that the end-use customer is securing at the wellhead. The Commission's jurisdiction to regulate these transactions is predicated on their impact on the operations of, and access to capacity on, interstate pipelines.

*Question No. 5a(1):* Are all sales in the market area considered "buy/sell" transactions?

*Answer:* No. Only transactions which have the fundamental feature discussed in answer to question No. 5a above are "buy/sell" transactions, regardless of where they occur.<sup>42</sup>

Accordingly, the Letter defines "buy/sell" transactions as requiring the purchase of gas supplies, either from or arranged by an end-user, by a firm shipper for sale to the end-user behind the city-gate. The Letter thus appears to support the conclusion that a required element of a "buy/sell" transaction is the involvement of an end-user as the purchaser and upstream seller of gas (or party arranging for the sale of gas to the firm shipper).<sup>43</sup>

In a brief to the District of Columbia Court of Appeals in the *El Paso* proceeding which established the Commission's prohibition against non-grandfathered "buy/sell" transactions, the FERC also defines "buy/sell" transactions narrowly—arguably limiting them to situations involving the sale by or on behalf of and resale back to an end-user where the capacity holder is an LDC.<sup>44</sup>

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42. Letter from Elizabeth Anne Moler, FERC Chairman, to John D. Dingell, United States Congressman, at 35, 38 (March 16, 1993) [hereinafter Letter] (copy on file with the author).

43. For example, in defining buy/sell arrangements, the Letter states that "the LDC or other firm capacity holder is using its priority to interstate pipeline capacity to act as an agent or broker of an end-use customer to effect deliveries of gas that the end-use customer is securing at the wellhead." *Id.* at 35. The Letter further states that the identity of the purchaser is relevant to determining whether a transaction is a prohibited "buy/sell" arrangement. "The initial purchaser in a 'buy/sell' arrangement is generally a holder of firm capacity on an interstate pipeline and the ultimate purchaser must be the designated customer for whom the initial purchaser purchased the gas." *Id.* at 36.

44. In its brief in *United Distribution Cos. v. FERC*, No. 92-1485 (D.C. Cir.), the FERC states the following:

The essence of a buy/sell transaction is that a holder of capacity rights on an interstate pipeline, such as an LDC, reallocates that capacity to a specific customer by arranging with the customer to locate, negotiate (and, in some cases, actually purchase) its own gas supplies from the wellhead and to use the LDC's transportation rights on the interstate pipeline to move that gas supply to the LDC's distribution facilities or the customer's plant.

Brief for the FERC at 32. However, FERC's brief also states that "buy/sells were prohibited because they enabled LDCs—free from Commission oversight, and the competitive bidding and public disclosure requirements of Order No. 636—to market and reallocate interstate pipeline capacity rights to specific customers by packaging them within direct sales transactions." *Id.* at 36. Further, the FERC brief states that, "[w]ith the flexible delivery point authority established by Order No. 636, an LDC may

These definitions, while legitimate as examples, are inconsistent with the scope and rationale of the prohibition set forth by the orders themselves.<sup>45</sup> With one exception noted below, Chair Moler's characterization of "buy/sell" transactions in the Letter and FERC in the *El Paso* court brief cannot reasonably be relied upon to limit the scope of the orders.<sup>46</sup> The language of FERC orders provides no clear exceptions to the prohibition against nongrandfathered "buy/sell" transactions. In particular, those orders speak in terms of a broad prohibition against circumventing FERC's capacity release program.<sup>47</sup> Order 636-B applies the policy to all holders of firm capacity, not merely to LDC capacity holders. The rationale of these orders suggests a broad prohibition against nongrandfathered "buy/sell" transactions involving the purchase and resale of gas by a firm pipeline capacity holder, where the purchaser of gas from the shipper after transportation by the pipeline is also the seller of gas to the shipper (or arranged for the sale to the shipper). This rationale would seem to require that the prohibition not be limited by the type of entity involved in the sale and repurchase of gas to the capacity holder. Thus, a transaction that involves the upstream sale of gas to a firm capacity holder for shipment on an interstate pipeline for resale to the upstream seller at or downstream of the pipeline delivery point would seem to qualify as a prohibited "buy/sell" transaction whether the firm capacity holder is an LDC or not, and whether the seller and repurchaser of the gas is an end-user or not.

Gas shipments under interruptible, as opposed to firm, pipeline capacity rights is the one supportable exception to the broad prohibition against all nongrandfathered "buy/sell" transactions provided by Order 636<sup>48</sup> and *El Paso*. The scope of FERC's uniform capacity release program which applies only to firm capacity rights supports the interpretation provided in the Letter that only firm capacity rights are implicated by the prohibition against "buy/sell" transactions.<sup>49</sup> Arguably, therefore, the purchase and

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now deliver gas at any established delivery point upstream of its city-gate . . . which makes all end-users with delivery taps along the interstate pipeline's route to the city-gate the relevant market for potential buy/sells." *Id.* at 42. Finally, the FERC states that "[b]uy/sells, on the other hand, divert pipeline capacity from the interstate market by enabling LDC's to reallocate it to specific end-users without notice to others seeking that capacity, and without affording the interstate market an opportunity to bid for that capacity." *Id.* at 44.

45. The briefs of a Commission have been accepted as official pronouncements of the Commission. *See, e.g.,* *Shurberg Broadcasting of Hartford, Inc. v. FCC*, 876 F.2d 902, 907 (D.C. Cir. 1989), *rev'd on other grounds, Metro Broadcasting, Inc. v. FCC*, 497 U.S. 547 (1990) (noting inconsistencies between two previous Commission briefs). But these pronouncements cannot supplant the language and rationale of the very orders under review. *See, e.g., Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168 (1962) (holding that when an argument to justify Commission's past actions is later made by a Commission's counsel, courts may not accept appellate counsel's post hoc rationalization for agency action).

46. *See* sources cited *supra* notes 41, 45. *See generally* *Bowles v. Seminole Rock & Sand Co.*, 325 U.S. 410, 414 (1945) (stating that an administrative interpretation is controlling unless inconsistent with the regulation).

47. *See* 59 F.E.R.C. ¶ 61,032 (1992). *See also* Order No. 636-B, *supra* note 15, at 62,002-03; 59 F.E.R.C. ¶ 61,031.

48. Order No. 636, *supra* note 16.

49. *See*, for example, the following question and answer in the Letter:

resale of gas in a transaction that might otherwise bear the indicia of a "buy/sell" would not be prohibited where the shipper moves the gas to the pipeline delivery point through interruptible capacity.<sup>50</sup> However, there is no assurance that the Commission would not assert jurisdiction if it believes that the transaction is an attempt to circumvent the prohibition against "buy/sell" transactions, creates an impediment to the development of a competitive secondary market for capacity, or otherwise results in undue discrimination.<sup>51</sup>

### III. CONCLUSION

The shipment of shipper-owned gas for sale after delivery by the interstate pipeline is permissible unless it qualifies as a nongrandfathered "buy/sell" transaction. The definition of "buy/sell" transaction is not clear as a result of FERC's various pronouncements on the project. The rationale of FERC's orders and policy supports the conclusion that any arrangement involving the shipment of gas purchased by a firm capacity holder upstream of the pipeline and subsequently resold by the shipper downstream of the pipeline to the same upstream seller constitutes a "buy/sell" transaction. There is an arguable basis to limit the definition to purchase and sale arrangements involving LDC firm capacity holders and seller/repurchasers that are end-use customers of the LDCs. Such an interpretation is subject to challenge, however, given the findings and broadly stated rationale of FERC's orders and policy. The better interpretation is that any shipper may transfer its *firm* transportation capacity rights to any other shipper only through a pipeline's capacity release program unless a shipper has a transportation contract that is grandfathered under a pre-Order 636 capacity brokering, capacity release, or capacity assignment program, or under a

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*Question No. 5e:* Does the extension of the ban to "all holders of capacity" mean that interruptible and other non-firm shippers are now subject to the prohibition of "buy/sell" transactions? If so, please provide the rationale for extending the prohibition to interruptible shippers. Include a listing for 1992 of all interruptible shippers' sales transactions that may be subject to the sales prohibition and provide an estimate of the additional staff resources required to enforce the prohibition against these sales.

*Answer:* No. The definition of "buy/sell" transactions subject to the Commission's orders discussing the eventual prohibition of "buy/sell" transactions was not expanded to include transactions involving the use of interruptible or other non-firm capacity. The Commission, in Order No. 636-B, found only that the prohibition was not limited to LDCs.

Letter, *supra* note 42, at 38.

50. The explanation provided in the Letter was that "[t]he definition of 'buy/sell' transactions subject to the Commission's orders discussing the eventual prohibition of 'buy/sell' transactions was not expanded to include transactions involving the use of interruptible or other non-firm capacity. Again, the Commission, in Order No. 636-B [61 F.E.R.C. ¶ 61,272, at 62,002], found only that the prohibition was not limited to LDCs." *Id.* The reference to "other non-firm capacity" is somewhat ambiguous. *Id.* at 38.

51. The Commission's interpretation of its jurisdiction over these matters is extremely broad. *See* 60 F.E.R.C. ¶ 61,117, at 61,384 (holding "a state regulatory agency may not regulate in this area in such a way as to intrude, even indirectly, on areas of exclusive federal authority"). The Commission also indicates that any form of target sales approach may be vulnerable to challenge on discrimination grounds. 60 F.E.R.C. ¶ 61,113, at 61,372-73. *See also Citizens Gas Supply Corp.*, 61 F.E.R.C. ¶ 61,036, at 61,181 (1992).

grandfathered "buy/sell" agreement. The lack of clarity of the Commission's policy has encouraged the very kind of discrimination among gas sellers and shippers that its policy sought to prevent.