Report of the Committee on Natural Gas Certificate and Authorization Regulations*

I. Optional Certificates

The Federal Energy Regulatory Commission's (FERC or Commission) Optional Certificate (OC) policy was affirmed by the United States Court of Appeals for the District of Columbia Circuit in a decision issued April 3, 1990.[1] The Commissions OC procedures, adopted in Order No. 436, were challenged by the Public Utilities Commission of the State of California (CPUC) and other petitioners after FERC granted an OC to Wyoming-California Pipeline Company (Wy-Cal) in 1988.

The petitioners argued, *inter alia*, that the FERC's ruling in the Wy-Cal proceeding violates the Supreme Court's ruling[2] which requires that mutually exclusive applications be considered in an "equal, even-handed, and non-prejudicial" manner. The Court held that the *Ashbacker* doctrine did not apply.

Additionally, the Court ruled that Wy-Cal's competitors, Mojave Pipeline Company (Mojave) and Kern River Gas Transmission Company (Kern) were not prejudiced by the FERC's action in Wy-Cal. In fact, prior to the D.C. Circuit's ruling, on January 24, 1990, FERC granted optional certificates to both Mojave and Kern River to construct facilities to serve the Enhanced Oil Recovery (EOR) marked under a settlement agreement between Kern River, Mojave, and Souther California Gas Company (SoCal). The authorized facilities consist of Kern's facilities, Mojave's facilities, and the "Common Facilities" which will be owned and operated by Kern and Mojave as tenants in common.

II. Iroquois Gas Transmission

The Commission issued certificates in November, 1990 authorizing construction and operation of the Iroquois Gas Transmission System (Iroquois) from the Canadian border across New York and Connecticut. The 370-mile pipeline will transport almost 600 MMcfd of Canadian natural gas for 20 shippers in the northeastern United States. Roughly 40% of the Iroquois volumes will be delivered to Tennessee Gas Pipeline Company (Tennessee) for redelivery to shippers in New York, Connecticut, Massachusetts, Rhode Island and New Hampshire. The Commission's order also authorized Tennessee to construct some 63 miles of pipeline and 8,650 horsepower of compression to provide these services.

Iroquois originally had sought an optional certificate under the Part 157, Subpart E regulations in its original 1986 filing. After Congress prohibited the

* The committee wishes to thank J. Wade Lindsey of Wilkinson, Barker, Knaver, & Quinn, Michael C. Tierney of Chadbourne and Parke, and Robert W. Burke, Jr. of Hunton and Williams for their help in preparing this report.

1. Public Util. Comm. of Cal. v. FERC, 900 F.2d 269 (D.C.Cir. 1990).
2. Ashbacker Radio Corp. v. FCC, 326 U.S. 327 (1945).

Commission from issuing an optional certificate without full NEPA review, a Commission solicitation resulted in seventy-two applications to serve the northeast market. The Iroquois-Tennessee project emerged from the Commission proceeding involving those applications.

The controversy surrounding the project continued. The Commission faced allegations that meetings of project proponents with FERC staff and Commissioners had exceeded bounds of propriety and the Commission's rules barring *ex parte* communications. These allegations led to an investigation by the FERC General Counsel.[3] The commission next issued an "Order Making Preliminary Determinations and Establishing Procedures."[4] This order addressed a number of the rate and environmental issued in the proceeding. The Commission concluded in the order that a hearing was not legally required on the principal contested issues of market need and competitive impact. Nonetheless, the Commission as a matter of policy set these issues for ann expedited formal "trial type" hearing. This hearing was narrowly focused by the Commission's order, which included a discussion of the Commission's preliminary view that there was a need for the gas to be delivered by the project, and that the fixed-variable rate structure used to transport gas within Canada to the Iroquois system did not give Canadian producers an unfair competitive advantage over U.S. producers. The Commission also set strict time limits for the conduct of the hearing: it concluded in less than forty-five days[5] and the Commission's final opinion and order[6] issued just two months later.

In addition to its unique procedural history, several of the Commission's substantive determinations in the *Iroquois* proceeding deserve brief mention:

> *Regulatory Risk.* At the same time the Commission acted, some Canadian and Department of Energy regulatory approvals were required before the gas proposed for the Iroquois project could flow. The Commission approved the project on the condition that the project sponsors accept the entire risk that failure of regulatory approvals would reduce project throughput during the life of the project. The commission also required Tennessee to depreciate its Iroquois-related facilities over a 40-year life, in contrast to the 20-year life granted to Iroquois itself or the maximum 20-year term of Canadian export authorizations. Tennessee has sought rehearing the "risk" condition as it applies to the rate base that would remain undepreciated after the first twenty years.
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> *Canadian Rate Design.* The Independent Producer's Association of America, an intervenor in the proceeding, argued that the marginal cost of buying Canadian gas would be artificially low, since almost all of the cost of transporting Canadian gas to northeast markets is recovered in Canadian demand charges, whereas the Commission's Modified-Fixed-Variable (MFV) methodology required U.S. pipelines to assess a high commodity charge in transporting U.S. gas to the northeast. The Commission concluded that (1) Opinion 256 (which required adjustment of Canadian demand charge costs in pipeline rates) did not apply to a transportation only pipeline such as Iroquois; (2) any difference in commodity transportation rates faced by U.S. and Canadian producers marketing to the Northeast was no greater than the differences between commodity rates charged by competitive

3. 52 F.E.R.C. ¶ 61,091 at, 61,428-40 (1990).
4. 52 F.E.R.C. ¶ 61,091 (1990).
5. 52 F.E.R.C. ¶ 63,031 (1990).
6. 53 F.E.R.C. ¶ 61,194 (1990).

U.S. pipelines; and (3) questions concerning the effect of pipeline transportation rates on competition between U.S. and Canadian gas supplied were best handled in individual pipeline Section 4 rate cases than in a pipeline certificate case.

Incremental Rate Design. The Commission denied Tennessee's request for authority to recover all of the incremental cost of Tennessee's new services throughout a 100% demand charge. However, the Commission recognized that an MFV rate design would not allow Tennessee to recover its cost of service because firm commodity rates for new service would be higher than Tennessee's interruptible rates from the same receipt points to the same delivery points. And—once Tennessee constructed the new capacity—it was highly unlikely that an Iroquois-Tennessee shipper need fear interruption if it nominated its Iroquois transportation volumes under the cheaper interruptible rate schedule. Shippers would therefore have a strong incentive to transport their Iroquois volumes under the interruptible rate schedule instead of the incremental rate schedule proposed by Tennessee. To avoid this anomaly, the Commission modified the MFV rate essentially by capping the firm commodity rate at Tennessee's existing interruptible rates and allocating all costs not recovered in the commodity rate (88% of the total) to demand charges.

Limited Jurisdiction Over Local Distribution Companies. The Commission found that the New York shippers were a part of the exchange transaction proposed by Texas Eastern in interstate commerce. Accordingly, the Commission asserted limited jurisdiction under the Natural Gas Act over their participation in the exchange.

III. Storage Certificate Developments

Pipelines cannot provide self-implementing storage services under Part 284 of the Commission's regulations. The Commission, however, sees storage as an integral part of open access transportation. In 1990 the Commission granted numerous blanket certificates under Natural Gas Act section 7(c) authorizing open access storage service.

In Colorado Interstate Gas Co.,[7] the Commission granted a blanket certificate authorizing open access storage service. Colorado Interstate Gas Company's (CIG) tariff provided that customers reducing or converting firm sales receive priority in the storage capacity allocation process. The Commission also approved CIG's proposal to make available 1 Mcf of withdrawal storage capacity for every 5 Mcf of general daily entitlements reduced or converted by firm sales customers, subject to revision after CIG has further experience with its service.

In *Williams Natural Gas Co.*,[8] the Commission clarified that (i) overrun service is nothing more than a request for new interruptible service and should be allocated capacity on a first-come, first-serve basis: (ii) firm storage customers are free to elect transportation under firm or interruptible transportation rate schedule; (iii) Williams may not retain gas free of charge at the end of the winter cycle where a customer's failure to withdraw gas caused by or within the control of Williams; and (iv) Williams may not abandon service under pregranted abandonment when a dispute exists regarding termination of the underlying transportation contract. The Commission further required Williams to perform an engineering study to determine available storage capacity

7. 50 F.E.R.C. ¶ 61,354 (1990).
8. 50 F.E.R.C. ¶ 61,386 (1990).

and to make the results publicly available prior to its open season, as well as making annual capacity determinations.

In *Natural Gas Pipeline Co. of America*,[9] the Commission approved three types of firm storage service (1) 30-day peaking service; (ii) 50-day peaking service; and (iii) 120-day annual service. The Commission also approved the design of an authorized overrun rate which take into account the maximum daily deliverability available under each of the types of FSS service. The Commission further approved a penalty consisting of an injection and withdrawal charge plus the authorized overrun rate for all volumes in excess of a customer's MDQ not recycled during a storage year.

In *Northwest Pipeline Corp.*,[10] the Commission required Northwest to offer interruptible open access storage in addition to the proposed firm service, consistent with the Part 284 transportation regulations. The Commission further clarified that Northwest must file maximum and minimum storage rates and that the minimum rate must reflect only the variable costs of providing the service. The Commission further clarified that Northwest must file maximum and minimum storage rates and that the minimum rate must reflect only the variable costs of providing the service. The Commission also clarified that unless distributor customers are firm sales customers in the process of converting to transportation, they are not entitled to be accorded any preference in capacity allocation.

In *ANR Storage Co.*,[11] the Commission rejected proposed lotteries for allocating storage capacity among (i) customers that request service during an open season for interruptible storage; and (ii) customers in the firm and interruptible service queues that submitted requests on the same day. The Commission required ANR Storage to institute time-stamping procedures and to allocate capacity among simultaneously filed requests on a pro rate basis.

Finally, in *Panhandle Eastern Pipe Line Co. and Pan Gas Storage Co., d.b.a. Southwest Gas Storage Co.*,[12] the Commission issued a blanket storage certificate while rejecting proposed rates to the extent found inconsistent with the *Equitable/ANR Pipeline* formulation.

In *Texas Eastern Transmission Corp.*,[13] the Commission issued an order approving a contested partial settlement involving the restructuring of service under Rate Schedule Winter Service (WS). The Commission issued a blanket certificate to Texas Eastern authorizing it to provide storage service on an open access basis.

The Commission modified the settlement to grant Staff's request that Texas Eastern be required to offer interruptible as well as firm storage service. Under the Part 284 regulations, a pipeline is required to offer both firm and interruptible transportation. Since storage services are merely an extension of the transportation system, storage customers also must be offered interruptible as well as firm open access storage service.

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9. 50 F.E.R.C. ¶ 61,385 (1990)
10. 50 F.E.R.C. ¶ 61,341 (1990).
11. 51 F.E.R.C. ¶ 61,114 (1990).
12. 53 F.E.R.C. § 61,227 (1990).
13. 53 F.E.R.C. § 61, 424 (1990).

IV. CONSTRUCTION OF SECTION 311 FACILITIES

During 1990, the Commission defined in greater detail the scope of authority for constructing facilities under section 311 of the Natural Gas Policy Act of 1978 (NGPA).[14] Issues involving construction under section 311 came under the Commission's review on several occasions.[15] However, the most significant discussion of construction under section 311 is contained in Commission Order Nos. 525 and 525-A.[16] The Commission issued its interim rule on construction simultaneously with other section 311 issuances.[17]

Order No. 525 is an interim rule requiring interstate pipelines to notify the Commission of its planned activities thirty (30) days prior to commencement of construction under section 311 of the NGPA or the planned replacement of certain facilities under section 2.55 of the Commission's regulations. The stated purpose of the interim construction rule is to temporarily offer a procedure by which the Commission is given the opportunity to review and take appropriate action where it appears that a significant environmental impact or other detriment to the public interest may occur as a result of such construction projects, which under the current regulations may occur without notification to the Commission.[18] The interim rule took effect upon issuance August 2, 1990 and will remain in effect until a final rule is issued.[19]

The notice required for construction conducted under section 284.3(c) of the Commission's regulations must include, *inter alia*, the following:

(1) A brief description of the facilities to be constructed or replaced;

(2) Evidence of compliance with each of the environmental terms and conditions

14. 15 U.S.C. §§ 3301-3432 (1980).

15. *See, e.g.*, Chairman's Letter dated January 5, 1990, to Senator Metzenbaum (D-Ohio); Survey of Interstate Transportation Activity Pursuant to the Authority of Section 311 of the NGPA, 52 F.E.R.C. § 61,157 (1990) (Data Request: Mar. 20, 1990) (Survey Released: Aug. 2, 1990); and *Foster's Report*, No. 1726, May 31, 1909, at 1.

16. Order No. 525, *Interim Revisions to Regulations Governing Construction of Facilities Pursuant to NGPA Section 311 and Replacement of Facilities*, III F.E.R.C. Stats. and Regs., ¶ 30,895, 55 Fed. Reg. 33,011 (1990); *Clarified* 52 F.E.R.C. ¶ 61,252 (1990); *reh'q denied*, Order No. 525-A, *Interim Revisions to Regulations Governing Construction of Facilities Pursuant to NGPA Section 311 and Replacement of Facilities*, 53 F.E.R.C. ¶ 61,140 (1990).

17. *See* Notice of Proposed Rulemaking, *Revisions to Regulations Governing Certificates for Construction*, IV F.E.R.C. Stats. and Regs., ¶ 32,477 55 Fed. Reg. 33,027 (1990); Notice of Proposed Rulemaking and Notice of Intent to Issue Order on Remand, *Revisions to Regulations Governing Transportation Under Section 311 of the Natural Gas Policy Act of 1978 and Blanket Transportation Certificates*, IV F.E.R.C. Stats. and Regs., ¶ 32,476 55 Fed. Reg. 33,017 (1990); *and* Order No. 526, *Interim Revisions to Regulations Governing Transportation under Section 311 of the Natural Gas Policy Act of 1978 and Blanket Transportation Certificates*, III F.E.R.C. Stats, and Regs., ¶ 30,894, 55 Fed. Reg. 33,002 (1990). *See also* Associated Gas Distrib. v. FERC, 899 F.2d 1250 (D.C. Cir. 1990) (remanding Commission's "on behalf of" interpretation under NGPA section 311). These orders are discussed elsewhere.

18. III F.E.R.C. Stats. and Regs., ¶ 30,895, at 31,812 (1990).

19. To that end, the Commission issued a Notice of Proposed Rulemaking, IV F.E.R.C. Stats and Regs. ¶ 32,477, 55 Fed. Reg. 33,027 (1990), "proposing numerous and significant changes to the regulations which should serve to expedite the Natural Gas Act (NGA) section 7 certificate process. It also proposes to amend the regulations to conform with the Commission's current practices and policies regarding the environmental review of construction projects." 53 F.E.R.C. ¶ 61,140, at 61,466 (1990).

in section 157.206(d);[20]
(3) U.S. Geological survey 7.5-minute series topographic maps showing the location of the facilities; and
(4) A description of the procedures to be used for erosion control, revegetation and maintenance, and stream and wetland crossings.

The notification required by this interim rule for replacement activity pursuant to section 2.55(b) of the Commission's regulations must include the information described in (1), (3), and (4) above.

In a subsequent order, the Commission clarified when replacement activity is deemed to commence.[21] The Commission stated that "commencement of replacement activities under section 2.55(b) begins once a written contract has been executed by all relevant parties for the performance of a rehabilitation project."[22] The Commission also provided guidance on how precise interstate pipelines must be in describing facilities to be replaced.

In Order No. 525-A, the Commission denied several parties' requests for rehearing of the Commission's interim construction rule (Order No. 525).[23] Among other things, the Commission found that it did not violate the Administrative Procedure Act's requirement for notice and comment by making the final rule effective upon its issuance on August 2, 1990.[24] The Commission likewise denied that the Order No. 525 notification requirements are unduly burdensome,[25] will result in delay of section 311 construction or replacement activities,[26] or are inconsistent with the Department of Transportation's pipeline safety regulations.[27]

V. INTERRUPTIBLE SALES SERVICE†

A. *Background*

Interruptible Sales Service (ISS) certificates issued by the Federal Energy Regulatory Commission (FERC or the Commission) authorize interstate pipelines to make interruptible sales for resale of natural gas in interstate commerce. ISS sales may be made to interstate pipelines, Hinshaw pipelines, local distribution companies and natural gas marketers. ISS certificates also authorize the pipeline to use its transmission facilities to make direct sales to end users.

Pipelines applying for ISS certificates cite the need to balance their daily

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20. Section 157.206(d) of the Commission's regulations embodies the current environmental requirements under section 311 of the NGPA. *See* 18 C.F.R. § 157.206(d) (1990).

21. Order Addressing Requests for Clarification, *Interim Revisions to Regulations Governing Construction of Facilities Pursuant to NGPA Section 311 and Replacement of Facilities*, 52 F.E.R.C. ¶ 61,252 (1990).

22. *Id.* at 61,876.

23. Order No. 525-A, *Interim Revisions to Regulations Governing Construction of Facilities Pursuant to NGPA Section 311 and Replacement of Facilities*, 53 F.E.R.C. ¶ 61,140 (1990).

24. *Id.* at 61,466-68.

25. *Id.* at 61,468.

26. *Id.* at 61,468-69.

27. *Id.* at 61,468-69.

† The Committee wishes to thank I. Wade Lindsey of Wilkinson, Barker, Knaver & Quinn for his assistance in preparing the Interruptible Sales Service section of this report.

supply and demand requirements as their primary reason for requesting such authority. ISS certificates are said to allow pipelines to provide a more reliable cash flow to their producer-suppliers, increase their market diversity, enhance their control of the operations of their systems, and buy more of the must-take volumes they are contractually obligated to purchase. Further, the pipelines assert that as a consequence of their being allowed to compete on an even basis with other sellers of natural gas the natural gas market will become more competitive and efficient.

1. Conditions Imposed by the Commission

a. Rate Conditions

ISS certificates generally impose a ceiling and a floor on the rate the pipeline can charge for an ISS sale. However, the Commission has determined that if the pipeline demonstrably lacks market power in the relevant market, the price floor[28] and ceiling[29] can be eliminated.

ISS certificates require pipelines to grant correlative discounts. To the extent a pipeline offers a discount to a customer in the transportation component of the ISS sales rate, it must offer a similar discount in its interruptible transportation rate to that customer. In early ISS orders, the Commission specified that an ISS pipeline had to offer correlative discounts to its interruptible transportation customers whenever it discounted the non-gas component of its ISS rate.[30] Among the issues in the Commission's current informal investigation of ISS certificates is whether the earlier or the later formulation of this condition is preferable.

Pipelines are required to credit part of the revenues received from ISS sales to their Account No. 191. Specifically, the pipeline must credit to Account No. 191 the current monthly weighted average cost of purchased gas, together with the fuel and company-use component of the interruptible sales rate. In addition, it must credit a representative out-of-period adjustment amount equal to the monthly average of such adjustments actually experienced during the most recent twelve months for which such information is available to the refund sub-account of Account No. 191.

b. Operational Conditions

ISS certificates contain conditions designed to ensure pipelines make ISS sales in non-discriminatory manner. ISS certificates include: 1) a requirement that ISS sales be subject to the pipeline's interruptible transportation queue; 2) a requirement that ISS service be provided to both on-system and

28. Transwestern Pipeline Co., 50 F.E.R.C. ¶ 61,361 (1990).

29. Transwestern Pipeline Co., 53 F.E.R.C. ¶ 61,298 (1990).

30. *Compare* Northern Natural Gas Co., 42 F.E.R.C. ¶ 61,303 (1988) *and* Transwestern Pipeline Co., 43 F.E.R.C. ¶ 61,240 (1988) *with* El Paso Natural Gas Co., 47 F.E.R.C. ¶ 61,139 (1989) *and* Transwestern Pipeline Co., 50 F.E.R.C. ¶ 61,362 (1990).

off-system customers under the same terms and conditions; and 3) pre-granted abandonment of all sales and transportation of gas for direct sales.

c. Reporting Requirements

A pipeline must report certain information to the Commission before making an ISS sale involving any of its affiliates. After review of the filing by Commission staff and publication of notice of the filing, the pipeline may begin making the sale. Protests must be filled within thirty days of the issuance of the notice. If a protest is filed, the pipeline may continue the transaction for 120 days, measured from the time sales begun, unless the Commission issues a termination order before the 120 days run.

Within thirty days of the commencement of service to a non-affiliate, the pipeline must report to the Commission the parties involved in the transaction, the beginning and ending dates of service, the estimated total and maximum daily quantities of gas to be sold or transported, the ultimate delivery point, the price and the applicable WACOG. Material changes must be reported within thirty days of the change.

The pipeline is required to make monthly and annual reports as well. Within 15 days after the end of a billing period during which it grants any ISS discounts the pipeline must inform the Commission of those discounts.

2. Pipelines Holding ISS Certificates

The Commission has issued ISS certificates to ten pipelines. Five pipeline applications for ISS certificates are pending.

B. Arkla Energy Resources, Inc.

On March 16, 1990, the Commission issued an Order Convening Technical Conference in *Arkla Energy Resources, Inc.*[31] Noting that none of the existing ISS certificates had been challenged on appeal, the Commission nevertheless stated that, before it expands the program further, there should be an inquiry into the sufficiency of the terms and conditions imposed on past ISS certificates. The Commission therefore convened a technical conference, seeking written as well as oral comments with respect to numerous specific issues set out in an appendix to the Order.

The Commission emphasized that the purpose and scope of the technical conference was not of a Section 5 proceeding under the Natural Gas Act. That is, the Commission did not intend to place at issue the lawfulness of any of the existing ISS certificates. Rather, the purpose and scope of the technical conference was to examine the sufficiency of the terms and conditions applied in past ISS certificates when measured by the demands of current and future market conditions. The Commission's general inquiry might be accepted by such existing sellers of ISS volumes.

The Appendix to the Order listed a number of questions to be addressed

31. Arkla Energy Resources, Inc., 50 F.E.R.C. ¶ 61,366 (1990).

in comments. Initial and reply comments were filed prior to the technical conference on May 2, 1990. Five panels (each made up of from 4 to 7 individual participants) spoke at the technical conference which was presided over by senior Commission staff members. Supplemental written comments were submitted following the technical conference.

This general ISS inquiry by the Commission was listed for discussion at the open meetings of July 25, September 12 and September 26, 1990, but was struck from the agenda each time.

C. *Individual ISS Proceedings*

The Commission has also addressed in several individual pipeline proceedings ISS issues such as rates, the transfer of title at receipt points, and the potential for undue discrimination of transportation in favor of IS service in individual pipeline proceedings. The Commission issued two orders regarding Transwestern Pipeline Company.[32] The Commission unbundles Transwestern's IS service from its transportation services by requiring that title to ISS gas transfer at the points where the ISS gas enters its system (*i.e.*, at the wellhead or at interconnect points with interstate and intrastate pipelines). Transportation to market will be performed pursuant to Transwestern's firm or interruptible transportation Rate Schedules. The Commission also permitted Transwestern to eliminate the minimum rate for its IS service. In a subsequent proceeding, the Commission, finding that the market will properly limit the ISS rate, permitted Transwestern to eliminate the maximum rate for its ISS service.[33]

The Commission issue an order on rehearing in *El Paso Natural Gas Company*,[34] finding that El Paso should change the point of title transfer of ISS gas from downstream delivery points to its mainline receipt points. Subsequently, in purported compliance with this order, El Paso filed tariff sheets in Docket No. ROP90-153-000 moving the point of title transfer of ISS gas back to the mainline receipt points and eliminating the minimum rate for IS service. The Commission accepted the tariff sheets for filing, effective on February 1, 1991, subject to refund and various conditions.[35] Requests for rehearing of this order are pending.

VI. NATURAL GAS BYPASS‡

The Commission has been steadfast in its policy under Section 7 of the Natural Gas Act (NGA)[36], allowing interstate pipelines to "bypass" local distribution companies and interconnect directly with large gas users. The Commission's bypass policy reflects its preference for allowing competitive forces to dictate the movement of natural gas from the wellhead to the burner tip.

32. Transwestern Pipeline Co., 50 F.E.R.C. ¶ ¶ 61,361, 61,362 (1990).
33. Transwestern Pipeline Co., 53 F.E.R.C. ¶ 61,136 (1990).
34. El Paso Natural Gas Co., 50 F.E.R.C. ¶ 61,363 (1990).
35. El Paso Natural Gas Co. 52 F.E.R.C. ¶ 61,227 (1990).

‡ The Committee wishes to thank Michael C. Tierney of Chadbourne & Parke for his assistance in preparation of the Bypass section of this report.

36. 15 U.S.C. § 717f (1988).

In determining whether to issue an NGA Section 7 certificate of public convenience and necessity authorizing construction of facilities necessary to implement a bypass, the Commission has repeatedly held that the primary issue is whether the service to be provided by the interstate pipeline reflects fair competition and does not unduly discriminate.[37] Unless a proposed bypass is shown to be clearly anti-competitive, LDSs must restructure their existing services or develop new services to compete with the pipelines proposing the new service. State commissions, not FERC, are responsible for programs and procedures that allow LDCs to remain or become competitive.

The Commission's current LDC bypass policy has been upheld in several decisions by the United States Courts of Appeals in cases involving bypasses by Williams Natural Gas Company (Williams) and Panhandle Eastern Pipe Line Company (Panhandle). The United States Court of Appeals for the District of Columbia Circuit recognized and affirmed this pro-competition policy in *Kansas Power & Light Co. v. FERC*,[38] by affirming the Commission's decision under NGA Section 7 to amend a certificate authorizing Williams to sell directly to the Atlas Powder Company (Atlas) all the gas Atlas required and to bypass the LDC, Kansas Power & Light Co. (KPL).[39]

In *Michigan Consolidated Gas Co. v. FERC*,[40] the D.C. Circuit affirmed the Commission's decision under Section 7 of the Natural Gas Act (NGA) authorizing Panhandle to install a tap and construct the facilities necessary to transport gas purchased in Oklahoma by National Steel Corporation's Great Lakes Steel Division (National Steel) directly to National Steel's facilities in Michigan, bypassing the LDC, Michigan Consolidated Gas Company (MichCon). The court held that approval of the bypass arrangement fell within the Commission's exclusive jurisdiction over interstate gas transportation under section 1(b)[41] of the NGA because title to the gas transferred to National Steel in Oklahoma not Michigan and "Panhandle's role under the arrangement is simply to transport National [Steel]'s gas from one state to another across several intervening states."[42]

In a related case[43] in which the Michigan Public Service Commission (MPSC) issued an order prohibiting Panhandle from interconnecting with National Steel, the United States Court of Appeals for the Sixth Circuit held

37. *See* Panhandle Pipeline Co., 46 F.E.R.C. ¶ 61,076, *reh'q denied*, 48 F.E.R.C. ¶ 61,233 (1989); Cascade Natural Gas Corp. v. Northwest Pipeline Corp., 46 F.E.R.C. ¶ 61,077 (1989), *reh'q denied*, 48 F.E.R.C. ¶ 61,234 (1989); Northern Natural Gas Co., 48 F.E.R.C. ¶ 61,232 (1989); Alabama-Tennessee Natural Gas Co., 51 F.E.R.C. ¶ 61,120 (1990); Texas Gas Transmission Corp., 49 F.E.R.C. ¶ 61,134 (1989), *reh'q denied*, 50 F.E.R.C. ¶ 61,291 (1990).

38. Kansas Power & Light Co. v. FERC, 891 F.2d 939 (D.C. Cir. 1989).

39. Williams or its predecessor had served the Atlas nitrogen plant directly since 1961. In 1987, Atlas built a pipeline between its nitrogen and explosives plant enabling Williams to provide service to both plants from Williams' existing tap at the Atlas nitrogen plant. Thus, Williams did not need to construct any new facilities to provide service to the explosives plant.

40. Michigan Consol. Gas Co. v. FERC, 883 F.2d 117 (D.C. Cir. 1989), *cert. denied*, 110 S.Ct. 1807 (1990).

41. 15 U.S.C. § 717(b) (1988).

42. *Michigan Consol.*, 883 F.2d at 121.

43. Michigan Consol. Gas Co. v. Panhandle E. Pipe Line Co., 887 F.2d 1295 (6th Cir. 1989), *cert. denied*, 110 S. Ct. 1807 (1990).

that the Panhandle-National Steel bypass "involves merely interstate transportation of natural gas. . . and not local distribution" or its functional equivalent.[44] The court further ruled that the Commission's exclusive, federal authority over the interstate transportation of natural gas preempted regulation of the panhandle-National Steel bypass by the MPSC.

The United States Court of Appeals for the Tenth Circuit issued a similar holding in *Williams Natural Gas Co. v. City of Oklahoma City*.[45] *Williams* involved a twelve-mile extension of Williams' interstate system to the PowerSmith Cogeneration project (PowerSmith), bypassing the LDC, Oklahoma Natural Gas Company (ONG). The Tenth Circuit held that the federal district court should have enjoined the state court proceedings initiated by ONG and that the state court order prohibiting Williams from exercising its rights under the FERC NGA Section 7 certificate to construct the necessary facilities "constituted an impermissible collateral attack on a FERC order in contravention of section 19 of the NGA."[46] Since ONG had appealed FERC's certificate orders to the D.C. Circuit, the Tenth Circuit deferred to the D.C. Circuit a decision on whether the Commission's certificate to Williams was lawful and preempted Oklahoma City franchise law.

In *Oklahoma Natural Gas. Co.V. FERC*,[47] the D.C. Circuit rejected Oklahoma Natural Gas' (ONG) claims that the Williams to PowerSmith pipeline extension is exempt from FERC jurisdiction as a local distribution facility or, alternatively, that the pipeline is exempt from FERC justification as a gathering facility. However, the court accepted ONG's argument that "all of the gas that PowerSmith will actually use originates and is physically transported and consumed in Oklahoma."[48] The court found FERC's assertion of jurisdiction perplexing since "the gas actually delivered to PowerSmith will never leave Oklahoma. . . ."[49] The court has difficulty accepting and understanding the Commission's reliance on the holding in *California v. Lo-Vaca Gathering Co.*,[50] since the Commission's assertion of jurisdiction here was based on transportation in interstate commerce not on a sale for resale as in *Lo-Vaca*.

On remand[51] FERC maintained its prior decision that the proposed extension by Williams "is an interstate pipeline, subject to the Commission's jurisdiction."[52] The Commission found that "the backhaul arrangement constitutes interstate nature of Williams' system itself"[53] because the economic effect of the transaction is that gas is transported in interstate commerce. FERC also found "the proposed pipeline is a tie-in facility that connects an

44. *Michigan Consol. v. Panhandle*, 887 F.2d at 1300.

45. Williams Natural Gas Co. v. City of Oklahoma City, 890 F.2d 255 (10th Cir. 1989), *cert. denied*, 110 S.Ct. 3236 (1990).

46. *Williams*, 890 F.2d at 264.

47. Oklahoma Natural Gas Co. v. FERC, 906 F.2d 708 (D.C. Cir. 1990).

48. *Id.* at 712.

49. *Id.* at 711.

50. California v. Lo-Vaca Gathering Co., 379 U.S. 366 (1965).

51. Williams Natural Gas Co., 52 F.E.R.C. ¶ 61,294, (1990), *reh'g denied*, 53 F.E.R.C. ¶ 61,399 (1990).

52. Williams Natural Gas Co., 52 F.E.R.C. ¶ 61,294 at, 62,156.

53. *Id.* at 62,157.

interstate pipeline to an end-user [and that,] [c]onsequently, any gas received by Williams for transportation to PowerSmith, even if it originates in Oklahoma, would be commingled in Williams' system with gas, some of which would ultimately be received by consumers in other states."[54]

Bypass issues also have arisen under section 3 of the NGA[55] in cases involving the importation of Canadian gas. In *Michigan Consolidated Gas Co. v. Energy Regulatory Administration*,[56] MichCon sought review of an order of the Energy Regulatory Administration (ERA) authorizing National Steel to import gas from Canada. MichCon claimed ERA failed to consider whether National Steel's use of imports for bypass purposes would shift costs to MichCon's remaining customers; improperly evaluated the competitiveness of Canadian imports; and violated section 3 of the NGA by authorizing National Steel to import more gas than it needed.[57] The court also found that because National Steel was purchasing gas in the open market and arranging transportation to its plant, "National [Steel]'s making provision to supply its needs through its own pipeline connecting it to Canadian sources, as an alternative to depending solely upon Panhandle, represents no cognizable injury to MichCon, and no injury at all that can be redressed by this court."[58] The court also found that MichCon could not convincingly argue that the ERA order authorizing the Canadian import arrangement made it more difficult for MichCon to compete for National's business because the ERA's decision was issued after the Commission approved the Panhandle connection.

Another case[59] concerning the Commission's jurisdiction under Section 3 of the NGA involved two industrial end-users in the State of Washington, Atlantic Richfield Company (ARCO) and Intalco Aluminum Corporation (Intalco), seeking Commission approval to construct a 30.7 mile pipeline to transport Canadian gas to their respective plants, bypassing Cascade Natural Gas Corporation, and LDC, and Northwest Pipeline Corporation. The Commission held that ERA, not FERC, is responsible for determining whether a proposed import is in the public interest and that FERC has "no occasion either to approve or disapprove the proposal, except for the site of importation at the international boundary."[60] The FERC also held that its "jurisdiction to attach section 7-type conditions to authorization granted under section 3 is discretionary, to be exercised as necessary to prevent or fill regulatory gaps or to protect the public interest."[61] The FERC determined that no regulatory gaps result from the proposal. Additionally, the Commission held that the possible competitive advantage to ARCO in the petroleum products market as a result of the proposed pipeline "is not the type of detriment to competition

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54. *Id.*

55. 15 U.S.C. § 717(b) (1988).

56. Michigan Consol. Gas Co. v. Energy Regulatory Admin., 889 F.2d 1110 (D.C. Cir. 1989).

57. *Id.* at 1111.

58. *Id.* National Steel had stopped taking any gas from MichCon and MichCon had disconnected National Steel from its distribution system.

59. Atlantic Richfield Co., 49 F.E.R.C. ¶ 61,294 (1989), *reh'g granted and denied in part*, 50 F.E.R.C. ¶ 61,210 (1990).

60. Atlantic Richfield Co., 49 F.E.R.C. ¶ 61,294, at 62,110.

61. *Id.* at 62,109 (footnote omitted).

envisioned by section 3 of the Natural Gas Act."[62]

VII. CAPACITY BROKERING§

In 1990, the Commission issued several orders[63] that authorized the implementation of capacity brokering and capacity assignment programs.[64] The Commission concluded that such programs "will promote efficient utilization of interstate pipeline capacity by increasing the amount of firm capacity available in the marketplace."[65]

In *Texas Eastern* and *Transco*, the Commission modified and approved virtually identical capacity brokering programs, widely regarded as models for the rest of the industry.[66] Under these brokering programs, firm transportation shippers may assign temporary surplus capacity directly to others, provided that the assigning shipper gives the pipeline at least 48 hours' notice prior to the assignment. Firm transportation shippers may also "repackage" firm capacity rights and assign firm rights on an interruptible basis.[67] Assignees of capacity rights may reassign such rights to others, subject to the conditions imposed by the previous assignor(s).[68]

The Commission applied several conditions to the brokering of capacity. First, shippers that broker capacity must do so on a "non-discriminatory, first-come, first-served" basis.[69] Second, assignment arrangements must extend for at least one month.[70] Third, unless the pipeline permits otherwise, assignments may include only the points of receipt and delivery specified in the firm

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62. *Id.* at 62,111.

§ The Committee wishes to thank Robert W. Burke, Jr. of Hunton & Williams for his Preparation of the Capacity Brokering section of this report.

63. Algonquin Gas Transmission Co., 53 F.E.R.C. ¶ 61,417 (1990) (Algonquin); East Tenn. Natural Gas Co., 53 F.E.R.C. ¶ 61,304 (1990); High Island Offshore Sys., 53 F.E.R.C. ¶ 61,126 (1990); U-T Offshore Sys., 53 F.E.R.C. ¶ 61,124 (1990); Viking Gas Transmission Co., 52 F.E.R.C. ¶ 61,015 (1990); Transcontinental Gas Pipe Line Corp., 52 F.E.R.C. ¶ 61,227 (1990) (Transco); Texas E. TRansmission Corp., 48 F.E.R.C. ¶ 61,248 (1989), *clarified*, 48 F.E.R.C. ¶ 61,378 (1989), *order on reh'q*, 51 F.E.R.C. ¶ 61,170 (1990), *order denying rehearing, modifying and clarifying prior orders, and addressing deferred issue*, 52 F.E.R.C. ¶ 61,273 (1990) (Texas Eastern); Wyoming-California Pipeline Co., 45 F.E.R.C. ¶ 61,234 (1988); *order amending prior orders*, 50 F.E.R.C. ¶ 61,070 (1990); Florida Gas Transmission Co., 51 F.E.R.C. ¶ 61,309 (1990); Midwestern Gas Transmission Co., 50 F.E.R.C. ¶ 61,221 (1990).

64. Lately, the Commission has used the term "capacity brokering program" to indicate a mechanism that permits customers or shippers to assign service rights directly to the other parties, and the term "capacity assignment program" to indicate a mechanism whereby customers or shippers may relinquish service rights back to the pipeline, which then reassigns such service rights to others.

65. *Algonquin*,, 53 F.E.R.C. ¶ 61,417, at 61,465.

66. *See also Algonquin*, 53 F.E.R.C. ¶ 61,417, at 61,465; *HIOS*, 53 F.E.R.C. ¶ 61,126, at 61,421-31; *U-TOS*, 53 F.E.R.C. ¶ 61,124, at 61,393-403 (approval of capacity brokering programs virtually identical to that approved for Texas Eastern); *Wy-Cal*, 50 F.E.R.C. ¶ 61,234, at 61,179 (requiring that the pipeline's proposed capacity brokering program be amended to include *Texas Eastern*-type conditions).

67. *Texas Eastern*, 52 F.E.R.C. ¶ 61,273, at 62,046-48; *Transco*, 52 F.E.R.C. ¶ 61,227, at 62,089 (finding that repackaging of firm capacity as interruptible encourages greater participation by LDCs that require the ability to recall capacity to meet their service obligations during peak periods).

68. *Texas Eastern*, 48 F.E.R.C. ¶ 61,248, at 61,866; *Transco*, 52 F.E.R.C. ¶ 61,227, at 62,086.

69. *Texas Eastern*, 48 F.E.R.C. ¶ 61,248, at 61,864; *Transco*, 52 F.E.R.C. ¶ 61,227, at 62,087.

70. *Texas Eastern*, 52 F.E.R.C. at ¶ 61,273, at 62,048; *Transco*, 52 F.E.R.C. ¶ 61,227, at 62,090 (reserving the right to review and, perhaps, repeal this condition within a year).

transportation service agreements between the original assignor and the pipeline.[71] Fourth, the original assignor of capacity remains responsible to the pipeline for compliance with all pipeline operating requirements, as well as the terms and conditions incorporated in the applicable rate schedule and underlying service agreement.[72]

The Commission permitted shippers brokering capacity to charge either a two-part rate, consisting of a reservation charge and a commodity charge, or a one-part rate for firm assignments of capacity.[73] Two-part rates may vary from the pipeline's as-billed rates, provided that (1) the assignor's reservation charge is no more than the reservation charge imposed by the pipeline and (2) the total charge imposed by the assignor generates revenues not exceeding that which would be generated under the rates charged by the pipeline.[74]

Assignors also have the option of charging a one-part rate, under which the assignor would "blend" the reservation and commodity components to the pipeline's two-part rate into a single volumetric rate.[75] The imposition of one-part rates is subject to numerous conditions.

Rates for capacity rights brokered on an interruptible basis may not exceed the pipeline's rate for interruptible transportation.[76] In addition, the rates must be volumetric and may not include a minimum bill provision, minimum take provision, or any other provision that has the effect of guaranteeing revenue for the assignor.[77]

The Commission has also approved several "capacity assignment programs" under which firm transportation shippers and sales customers may temporarily relinquish service rights back to the pipeline, which would then offer such rights to the pipeline's customers.[78] Under the capacity assignment program approved in *Florida Gas*, for example, shippers that desire to assign service rights must submit a written request to the pipeline, which then must offer such service rights to pipeline customers having submitted a valid request for service. If no party accepts the service offered by the pipeline, the shipper may locate an assignee and assign service rights directly to that party.[79] The Commission conditioned its approval of Florida Gas' capacity assignment program upon assurances by Florida Gas that its existing allocation of receipt

71. *Algonquin*, 53 F.E.R.C. ¶ 61,417, at 61,468 (denying request by shipper to impose flexible receipt and delivery points because "[a]n assignee can transfer rights no greater than it holds"); *Texas Eastern*, 48 F.E.R.C. ¶ 61,248 at 61,810; *Transco*, 52 F.E.R.C. ¶ 61,227, at 62,090-91 (stating that it would be improper to address changes in delivery points in the current proceedings).

72. Assignors remain responsible, for example, for the payment of all rates, charges, penalties, and fees for transportation service rendered by the pipeline. The assignor may pass any penalty payments through to the assignee responsible for the incurrence of the penalty. *Texas Eastern*, 48 F.E.R.C. ¶ 61,248, at 61,869; *Transco*, ¶ 61,227, at 62,086.

73. *Texas Eastern*, 51 F.E.R.C. ¶ 61,170, at 61,456; *Transco*, 52 F.E.R.C. ¶ 61,227, at 67,087-88.

74. *Texas Eastern*, 51 F.E.R.C. ¶ 61,170, at 61,456; *Transco*, 52 F.E.R.C. ¶ 61,227, at 62,088.

75. *Texas Eastern*, 51 F.E.R.C. ¶ 61,170 at 61,457; *Transco*, 52 F.E.R.C. ¶ 61,227, at 62,088.

76. *Texas Eastern*, 48 F.E.R.C. ¶ 61,248, at 61,869; *Transco*, 52 F.E.R.C. ¶ 61,227, at 62,089.

77. *Texas Eastern*, 48 F.E.R.C. ¶ 61,248, at 61,869; *Transco*, 52 F.E.R.C. ¶ 61,227, at 62,089.

78. *See, e.g.*, *East Tennessee*, 53 F.E.R.C. ¶ 61,304, at 61,133; *Viking*, 52 F.E.R.C. ¶ 61,015, at 61,109-10; *Florida*, ¶ 61,309, at 62,013-14; *Midwestern*, 50 F.E.R.C. ¶ 61,221, at 61,709-11.

79. *Florida*, 51 F.E.R.C. ¶ 61,309, at 62,013. This option was not made available to customers or shippers in *East Tennessee*, *Viking*, or *Midwestern*.

point capacity would not be "unilaterally" disrupted by the pipeline's capacity assignment program.[80] The Commission also required that the pipeline make clear in its firm transportation tariff that a shipper's position on the pipeline's transportation log would not be disturbed if the shipper declined to accept the assigned capacity offered by the pipeline.[81]

In *Midwestern*, the Commission determined that shippers that relinquished capacity to the pipeline would not be responsible for rate schedule and service agreement obligations with respect to service rights that subsequently are assigned by the pipeline to others.[82]

VIII. THE "ON BEHALF OF" REQUIREMENT OF SECTION 311

The Commission first set forth its interpretation of the "on behalf of" requirement of section 311 of the Natural Gas Policy Act of 1978 (NGPA) in Order No. 46.[83] In defining the necessary elements of a section 311 transaction, the Commission stated that "some nexus is required between the transporter and the party on whose behalf the transaction will be conducted. That nexus may be an agency relationship, or having title to the transported gas reside, during the transaction, in the party on whose behalf the transportation is being conducted."[84]

On July 19, 1988, the Commission issued a series of orders clarifying the "on behalf of" requirement of section 311. Chief among these was a declaratory order in response to a petition by Hadson Gas Systems, Inc. (Hadson) seeking confirmation that the requisite nexus between the transporter and the "on behalf of" party in a section 311 transaction is satisfied by an agency agreement.[85] In its decision in *Hadson*, the Commission stated that "as long as an LDC or an intrastate pipeline receives some economic benefit, there is a sufficient nexus to satisfy the 'on behalf of' requirement in NGPA Section 311(a)(1)."[86]

Associated Gas Distributors (AGD), an association of LDCs, petitioned the Court of Appeals for the D.C.Circuit for review of the Commission's decision in *Hadson* as well as two other Commission decisions involving Section 311 interpretations, *Texas Eastern Transmission Corp.* and *Cascade Natural Gas Corp. v. Northwest Pipeline Corp.*[87] on the grounds that the Commission's interpretation was overly broad.

On April 6, 1990 the Court of Appeals for the D.C. Circuit issued its Opinion in *Associated Gas Distributors v. FERC, (AGD-Hadson)*, finding the Commission's interpretation of section 311 to be "too broad to survive scru-

80. *Id.*

81. Id. at 62,014.

82. *Midwestern*, 50 F.E.R.C. ¶ 61,221, at 61,710-11.

83. Order No. 46, *Sales and Transportation of Natural Gas* [1977-1981 Regulations Preambles], F.E.R.C. Stats. and Regs. ¶ 30,081 (1979).

84. *Id.* at 30,537.

85. Hadson Gas Sys., Inc., 44 F.E.R.C. ¶ 61,082 (1988).

86. *Id.* at 61,253.

87. Texas E. Transmission Corp., 44 F.E.R.C. ¶ 61,080 (1988); Cascade Natural Gas Corp. v. Northwest Pipeline Corp., 44 F.E.R.C. ¶ 61,081 (1988).

tiny."[88] The Court stated that Congress intended Section 311 to be a limited exception to the certificate requirements of Section 7 of the NGA and was not intended to effect a sweeping change in the requirement that transportation of natural gas be authorized by a certificate issued prior to the transportation.[89] The Court vacated all three of the Commission's orders to the extent of their reliance on the invalid interpretation of the "on behalf of" test and remanded *Hadson* and *Texas Eastern* for further proceedings consistent with the Court' opinion.[90]

In response to the Court's opinion in *AGD-Hadson*, the Commission on August 2, 1990 issued and Interim Rule, Order No. 526.[91] The Interim Rule conservatively required that the "on behalf of" entity in a section 311 transportation transaction either (1) have physical custody and transport the gas at some point during the transaction or (2) hold title to the gas at some point during the transaction for a purpose related to its identify as a local distribution company, intrastate pipeline, or interstate pipeline. These two particular circumstances were mentioned favorably by the *AGD-Hadson* court as clearly falling within the ambit of section 311. The NOPR set forth the same interpretation adopted by the Commission's Interim Rule, and also would revise the notice and protest provisions of the section 7 blanket regulations to eliminate any existing preference for section 311 transportation over section 7 blanket certificate transportation.

As of the date of issuance of the Interim Rule, an interstate pipeline was no longer authorized to commence any new section 311 transportation service which did not satisfy the Interim Rule's "on behalf of" test. To mitigate adverse impact on existing section 311 services, the Interim Rule established procedures that would allow interstate pipelines a period of time (extended to November 1, 1990) to convert certain existing transportation services under section 311 of the NGPA to section 7 transportation services under their blanket transportation certificates issued pursuant to section 284.221 of the Commission's regulations.

James H. Norwood, *Chairman*
Douglas A. Oglesby, *Vice Chairman*

A. Hays Butler	Zori G. Ferkin
Edward H. Comer	H. Liza Moses
William D. DeGrandis	Mary Ann Ralls

88. Associated Gas Distrib. v. F.E.R.C., 899 F.2d 1250, 1263 (D.C. Cir. 1990).

89. *Id.* at 1262.

90. The Court did not remand Cascade for further proceedings because the NGPA Section 311 transportation transaction in Cascade had terminated and as such the issue was moot.

91. Order No. 526, *Interim Rule on Transportation Under Section 311 of the Natural Gas Policy Act of 1978*, III, F.E.R.C. Stats. and Regs. ¶ 30,894, 55 Fed. Reg. 33,002 (1990); Order No. 526-A, III F.E.R.C. Stats. and Regs. ¶ 30,899, 55 Fed. Reg. 40,828 (1990).