

# REPORT OF THE NATURAL GAS REGULATION COMMITTEE\*

This Report summarizes several major natural gas decisions and policy developments that were issued by or are under consideration at the Federal Energy Regulatory Commission (Commission or FERC) and the courts in 2004. The topics are covered in the following order:

- I. Gas Quality and Interchangeability,
- II. State of the Natural Gas Industry Conference and the FERC Staff Report on Natural Gas Storage,
- III. Update on Creditworthiness Issues,
- IV. The FERC's Force Majeure Reservation Charge Crediting Policy,
- V. D.C. Circuit Remand of the FERC's Discount Policy,
- VI. Policy Regarding the Outer Continental Shelf,
- VII. Update on Standards of Conduct Policy,
- VIII. Update on Handling Critical Energy Infrastructure Information,
- IX. Price Reporting/Manipulation,
- X. FERC Agreements Regarding Cooperation on Review of Pipeline/LNG Projects,
- XI. Policy on Alaska Natural Gas Transportation Projects,
- XII. Policy for Selective Discounting,
- XIII. Negotiated Rate/Index-Based Pricing Policy,
- XIV. Award of Available Capacity to Short-Haul Bids,
- XV. Jurisdictionality of LNG Facilities: *Sound Energy Solutions v. FERC*,
- XVI. Notice of Inquiry Regarding Whether FERC-Regulated Partnerships or Limited Liability Companies Can Include a Corporate Income Tax Allowance in Rates.

## I. GAS QUALITY AND INTERCHANGEABILITY

### A. The FERC Interchangeability Conference

On February 18, 2004, the FERC held a public conference in order to open "a dialogue about policy issues arising from natural gas interchangeability."<sup>1</sup> The conference was spurred by an earlier October 14, 2003 technical conference held by the FERC on the findings and recommendations contained in the National Petroleum Council's report: *Balancing Natural Gas Policy: Fueling the*

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\* The Committee thanks the following members for their valuable contributions to this report: Susan W. Ginsberg, Independent Petroleum Association of America; Joel F. Zipp, Bracewell & Patterson, L.L.P.; William S. Lavarco, Bracewell & Patterson, L.L.P.; Randall S. Rich, Bracewell & Patterson, L.L.P.; Jane Lewis, American Gas Association; James L. Blasiak, Dykema Gossett P.L.L.C.; David P. Sharo, NiSource Inc.; Jason F. Leif, Jones Day; Marcia C. Hooks, Federal Energy Regulatory Commission; Christopher J. Barr, Morgan, Lewis & Bockius L.L.P.; Stanley Wolf, Leonard, Street and Deinard, P.A.; Michael C. Dotten, Heller, Ehrman, White & McAuliffe L.L.P.; George R. Briden, Snake Hill Energy Resources, Inc.; Mark R. Haskell, Morgan, Lewis & Bockius L.L.P.; Joel A. Youngblood, Jackson Walker L.L.P.; Mary E. Bengel, Sullivan & Worcester L.L.P.; Nancy L. Pickover, FPL Energy, L.L.C.; and Sarah E. Tomalty, FPL Energy, L.L.C. This summary of natural gas regulatory developments is not intended to represent the positions or views of the contributors to this report, their clients, or their employers.

1. Notice of Public Conference, *Natural Gas Interchangeability*, 69 Fed. Reg. 3580 (2004).

*Demands of a Growing Economy.*<sup>2</sup> The Summary Report recommended that the natural gas interchangeability standards be updated: the “FERC and [the Department of Energy] should champion the new standards effort to allow a broader range of LNG [liquefied natural gas] imports. This should be conducted with participation from LDCs [local distribution companies], LNG purchasers, process gas users, and original equipment manufacturers (OEMs).”<sup>3</sup> In addition, the Commission stated in its Notice of the Conference that it “has dealt with gas quality and interchangeability issues in several recent cases, and others are pending.”<sup>4</sup>

During the conference, the Natural Gas Council (NGC)<sup>5</sup> “announced ‘an unprecedented coalition of stakeholders’ to address the issues of natural gas interchangeability and gas quality. . . . Don Santa [President of INGAA], outlined seven broad principles for framing the issues on the PL04-3 agenda.”<sup>6</sup> First, he established that “[t]he industry is committed to leading the development of a timely solution in coordination with the Commission.”<sup>7</sup> He then posited that any solution should: (1) “allow sufficient operational flexibility for the gas delivery system to maintain its integrity and reliability for diverse service regions and customer mix;” (2) “not limit a diverse gas supply;” (3) “recognize end-use equipment and customer needs;” (4) “be consistent with protecting public safety;” (5) “be cost-efficient;” and (6) “provide for required communications among parties.”<sup>8</sup>

Several speakers at the conference identified two discrete problems facing the industry: hydrocarbon liquids in the gas stream from current domestic production and introduction of high-Btu LNG into the pipeline grid. Among the recommendations advanced were that all pipelines should have certain common standards to allow a maximum amount of blending, but the Commission should take a pipeline-by-pipeline approach. Another theme was that heating value alone is not a true indication of interchangeability because it does not address the performance of the gas at the burner tip; instead, the heating value of the gas must be adjusted for its relative density to establish a specification that bears directly on performance. This can be done by using an interchangeability index, of which the most commonly used is the Wobbe Index,<sup>9</sup> which the speaker declared is “a much more meaningful indicator for end users than the current specifications based upon heating value.”<sup>10</sup>

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2. NAT'L PETROLEUM COUNCIL, 1 BALANCING NATURAL GAS POLICY: FUELING THE DEMANDS OF A GROWING ECONOMY (2003).

3. *Id.* at 64.

4. Notice of Public Conference, *Natural Gas Interchangeability*, 69 Fed. Reg. 3580 (2004).

5. The NGC is comprised of four major natural gas trade groups: the Interstate Natural Gas Association of America (INGAA), the Natural Gas Supply Association (NGSA), the American Gas Association (AGA), and the Independent Petroleum Association of America (IPAA).

6. *Natural Gas Interchangeability & Quality Standards are Separate Issues, Many Say; Let the Natural Gas Council Take the Lead*, FOSTERS NAT. GAS REP., Mar. 25, 2004, at 6.

7. *Panelists Discuss Technical, Regulatory and Economic Issues at Conference on Gas Quality; Natural Gas Council Presents Framework for Solutions*, FOSTERS NAT. GAS REP., Feb. 19, 2004, at 5.

8. *Id.*

9. The Wobbe Index is defined as the Gross Calorific Value (CV) divided by the Square Root of the Specific Gravity (SG).

10. *Panelists Discuss Technical, Regulatory and Economic Issues at Conference on Gas Quality*;

Various parties filed follow-up comments after the conference. Although there was no universal agreement with respect to the steps the FERC should take, there was a general consensus that some action is required, and many of the comments indicated that a one-size-fits-all standard is not the right approach.<sup>11</sup> A number of comments also reiterated that interchangeability of LNG and gas quality standards are different issues and should be addressed separately.<sup>12</sup>

The FERC has not taken further action in Docket No. PL04-3-000.

### *B. White Paper on Natural Gas Interchangeability*

The NGC Interchangeability Task Group issued a Consensus Item list on July 23, 2004.<sup>13</sup> Among the consensus items listed were: (1) that “BTU specification alone . . . is not an adequate measure for gas interchangeability;” (2) “[t]he Wobbe Index provides the most efficient and robust measure of gas interchangeability;” (3) “[g]as interchangeability guidelines need to consider historical and regional gas compositional variability as well as future gas supplies;” and (4) international experience, particularly European, provides useful precedent.<sup>14</sup> The NGC Interchangeability Task Group issued its second draft “White Paper on Natural Gas Interchangeability” in September 2004.<sup>15</sup> The draft White Paper provides an overview of current United States sources of gas supply, with an emphasis on increased LNG importation, and how this changed supply is affecting end use. The NGC Interchangeability Task Group issued a draft Executive Summary for the White Paper on December 17, 2004.<sup>16</sup> This draft executive summary includes recommendations and proposes interim interchangeability guidelines for gases delivered to end-users until further data is developed.

The final “White Paper on Natural Gas Interchangeability” is expected to be complete in early 2005.

### *C. The FERC Cases on Interchangeability and Gas Quality Issues*

Following is an overview of the various cases addressing interchangeability

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*Natural Gas Council Presents Framework for Solutions*, FOSTERS NAT. GAS REP. , Feb. 19, 2004, at 5.

11. See, e.g., Comments of Statoil ASA and Statoil Natural Gas LLC, *Natural Gas Interchangeability*, FERC Docket No. PL04-3-000 (2004); Comments of The Process Gas Consumers Group, *Natural Gas Interchangeability*, FERC Docket No. PL04-3-000 (2004).

12. See, e.g., Comments of SCANA Corporation, *Natural Gas Interchangeability*, FERC Docket No. No. PL04-3-000 (2004) (SCANA Corporation’s Comments following February 18, 2004, Public Conference). Comments of International LNG Alliance and the International Gas Union, *Natural Gas Interchangeability*, FERC Docket No. PL04-3 (2004); Comments of John Hiritcko, Jr. On Behalf of Shell US Gas & Power, LLC, *Natural Gas Interchangeability*, FERC Docket No. PL04-3 (2004).

13. AM. GAS. ASS’N, CONSENSUS ITEMS: GAS INTERCHANGEABILITY TASK GROUP (2004), available at [http://www.aga.org/Content/ContentGroups/Operations\\_and\\_Engineering2/Gas\\_Quality/ConsensusItemsJuly23.pdf](http://www.aga.org/Content/ContentGroups/Operations_and_Engineering2/Gas_Quality/ConsensusItemsJuly23.pdf).

14. *Id.*

15. NGC+ INTERCHANGEABILITY TASK GROUP, WHITE PAPER ON NATURAL GAS INTERCHANGEABILITY (2004), available at [http://www.aga.org/Content/ContentGroups/Operations\\_and\\_Engineering2/Gas\\_Quality/tedwhitepaper.pdf](http://www.aga.org/Content/ContentGroups/Operations_and_Engineering2/Gas_Quality/tedwhitepaper.pdf).

16. NGC+ INTERCHANGEABILITY WORK GROUP, WHITE PAPER ON NATURAL GAS INTERCHANGEABILITY AND NON-COMBUSTION END USE (2004), available at <http://www.naesb.org/pdf/update011905w10.pdf>.

and/or gas quality issued by the Commission during 2004.

1. *Northern Natural Gas Co.* – Docket No. RP04-155-000

On July 29, 2004, the Commission rejected tariff revisions proposed by Northern Natural Gas Company (Northern) that would have revised its gas quality standards to lower acceptable levels of carbon dioxide and oxygen.<sup>17</sup> Northern filed the tariff revisions as part of a larger rate case filing wherein it proposed to lower the acceptable level of carbon dioxide from 2% to 1%, and the acceptable level of oxygen from 0.2% to 0.02%.<sup>18</sup> Northern stated that it proposed these changes to minimize pipeline corrosion in response to industry research and an advisory issued by the Office of Pipeline Safety. On February 27, 2004, the FERC issued an order setting Northern's proposed gas quality changes for a technical conference.<sup>19</sup> In a July 29, 2004 order issued subsequent to the technical conference, "the Commission f[ound] that Northern ha[d] failed to present sufficient evidence in its pleadings in this proceeding to show that its proposal is just and reasonable" and "reject[ed] Northern's proposal to restrict carbon dioxide and oxygen tolerance levels for gas entering its system, without prejudice to its making a new proposal to address any corrosion problems on its system."<sup>20</sup> Northern has not filed any new proposals to change its gas quality standards.

2. *Indicated Shippers v. Trunkline Gas Co.*, Docket No. RP04-64-000 and *Indicated Shippers v. ANR Pipeline Co.*, Docket No. RP04-65-000 (not consolidated)

Indicated Shippers, in this pair of separate but similar complaints, charged that Trunkline Gas Company, LLC (Trunkline) and ANR Pipeline Company (ANR) improperly changed the Btu content of gas that they will accept by means of Operational Flow Orders (OFOs) and "Critical Notices instead of filings under Section 4 of the Natural Gas Act."<sup>21</sup> On December 30, 2003, the FERC issued an order finding that these "pipelines may not permanently decrease the Btu content of gas they will accept through OFOs and Critical Notices, direct[ed] them to cease and desist from this practice, and require[d] them to remove OFOs and Critical Notices limiting the Btu content of gas from their web sites."<sup>22</sup> The Commission stated that "Trunkline's and ANR's practice of making their gas quality standards more restrictive through posting notices on their web sites [was] contrary to Section 4(d) of the NGA" and found the pipelines "have

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17. *N. Natural Gas Co.*, 108 F.E.R.C. ¶ 61,083 (2004).

18. *Id.*

19. *N. Natural Gas Co.*, 106 F.E.R.C. ¶ 61,195 (2004).

20. 108 F.E.R.C. ¶ 61,083, at 61,420.

21. *Indicated Shippers*, 106 F.E.R.C. ¶ 61,040, 61,152 (2004). Indicated Shippers also filed two additional complaints on these issues against Columbia Gulf Transmission Company (Columbia Gulf) and Tennessee Gas Pipeline Company (Tennessee) in Docket Nos. RP04-98-000 and RP04-99-000, respectively. On January 26, 2004, the Commission issued an order finding that although both Columbia Gulf and Tennessee's tariffs provided sufficient authority by which they could adopt additional gas specifications, these tariff provisions provided the pipelines too much discretion to vary gas quality standards without notice to customers and ordered the pipelines to revise their tariffs to limit such discretion.

22. *Indicated Shippers*, 105 F.E.R.C. ¶ 61,394, 62,743 (2003).

improperly used OFOs or Critical Notices to make permanent changes to their tariffs.”<sup>23</sup> The Commission also noted that “OFOs are concerned with the flow of gas and with maintaining the correct pressures in the pipeline in order to sustain the reliability of pipeline deliveries” and “are intended to be used for temporary and transient emergency situations.”<sup>24</sup> The Commission also refused to address the issue of whether to promulgate industry-wide “standards for gas quality in [the] order.”<sup>25</sup> On March 8, 2004, the Commission issued an order denying rehearing of the Trunkline proceeding.<sup>26</sup>

### 3. *ANR Pipeline Co.*—Docket No. RP04-216-000

As a result of the above complaint proceeding, ANR filed tariff provisions to change its hydrocarbon dewpoint (HDP)<sup>27</sup> and to make other changes to its gas quality specifications.<sup>28</sup> “ANR propose[d] that the HDP safe harbor for its system w[ould] be 15 degrees Fahrenheit.”<sup>29</sup> Thus, ANR would “not refuse to accept delivery of gas with an HDP equal to or less than 15 degrees Fahrenheit, provided that the gas meets the other applicable provisions of ANR’s Tariff.”<sup>30</sup> ANR further proposed “that it may accept gas with a higher HDP than that” posted “to the extent operationally practicable through aggregation or other reasonable means.”<sup>31</sup> On April 30, 2004, the FERC issued an order rejecting ANR’s proposed safe harbor HDP provision, claiming that ANR had “not provided enough supporting documentation to fully justify its proposed tariff revision as required by . . . the Commission’s regulations.”<sup>32</sup> The Commission also noted in this same order that because “issues of gas interchangeability and merchantability are national issues, the Commission would prefer, if the industry can reach agreement, to have standards that take into account the movement of gas throughout the pipeline grid.”<sup>33</sup> The Commission further added: “[i]f the industry cannot achieve a consensus on some or all of the gas merchantability and interchangeability issues on the delivery end of the pipelines, the Commission will have to use other means to address the issues.”<sup>34</sup>

### 4. *Toca Producers v. Southern Natural Gas Co.*—Docket No. RP03-484-000

On February 17, 2004, the Commission issued an order<sup>35</sup> denying rehearing

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23. *Id.* at 62,746.

24. 105 F.E.R.C. ¶ 61,394, at 62,746.

25. *Id.* at 62,747.

26. *Indicated Shippers*, 106 F.E.R.C. ¶ 61,232 (2004).

27. HDP refers to the temperature below which some constituents of the natural gas stream become liquids.

28. *ANR Pipeline Co.*, 107 F.E.R.C. ¶ 61,094, 61,296 (2004).

29. *Id.*

30. 107 F.E.R.C. ¶ 61,094, at 61,296.

31. *Id.*

32. 107 F.E.R.C. ¶ 61,094, at 61,299.

33. *Id.* at 61,299–300.

34. *ANR Pipeline Co.*, 107 F.E.R.C. ¶ 61,094, 61,300 (2004).

35. *The Toca Producers*, 106 F.E.R.C. ¶ 61,158 (2004).

of its September 16, 2003 order<sup>36</sup> dismissing the complaint filed by the Toca Producers against Southern Natural Gas Company (Southern). The Toca Producers<sup>37</sup> complaint “requested an evidentiary hearing in order to establish, among other things, just and reasonable natural gas hydrocarbon dewpoint (HDP) quality specifications in Southern’s tariff.”<sup>38</sup> The Commission held in its February 17 Order that “[c]ontrary to the Toca Producers’ assertion, the September 16 Order addressed their contention of undue discrimination [regarding] Southern . . . holding the Toca Producers to a different processing standard than other gas entering its system.”<sup>39</sup> The February 17 Order concluded that the “Commission regulations do not require pipelines to include any specific type of gas quality standards,”<sup>40</sup> and “Southern was not discriminating in applying the specific gas quality standard included in its tariff.”<sup>41</sup> On April 9, 2004, the Commission issued an order denying further rehearing by operation of law.<sup>42</sup> This proceeding is now on judicial review before the U.S. Court of Appeals for the D.C. Circuit.<sup>43</sup>

5. *AES Ocean Express LLC v. Florida Gas Transmission Co.*—Docket No. RP04-249-000

On June 18, 2004, the FERC issued an order on a complaint by AES Ocean Express, LLC (AES) against Florida Gas Transmission Company (FGT).<sup>44</sup> AES’s complaint alleged that FGT was insisting on unreasonable conditions in a proposed interconnection agreement between FGT and AES’s proposed pipeline. Several of these conditions related to gas quality and interchangeability in conjunction with the introduction of LNG from AES’s planned pipeline into the FGT system. Notwithstanding the fact that AES has yet to begin construction of its project, the Commission addressed these issues, stating, “[g]iven the long lead time between project inception and the beginning of operation of a new source of LNG, decisions need to be made now on gas quality and interchangeability requirements which are essential to project planning and financial arrangements.”<sup>45</sup> The Commission exercised “its authority under Section 5 of the NGA, and directed [FGT] to file tariff revisions related to gas quality and interchangeability standards within 30 days of this order, to be effective in accordance with further Commission action.”<sup>46</sup> The Commission further found that it was “not appropriate for [FGT] to negotiate gas quality standards individually in the interconnection agreement;” rather such changes needed to be

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36. *The Toca Producers*, 104 F.E.R.C. ¶ 61,300 (2003).

37. “The Toca Producers . . . are comprised of BP America Production Company (successor to Amoco Production Company), Chevron U.S.A. Inc., ExxonMobil Gas & Power Marketing Company, and Shell Offshore, Inc.” *The Toca Producers*, 106 F.E.R.C. ¶ 61,158, 61,526 n.1.

38. *Id.* at 61,526 (footnote omitted).

39. 106 F.E.R.C. ¶ 61,158, at 61,528.

40. *Id.* at 61,530.

41. 106 F.E.R.C. ¶ 61,158, at 61,528.

42. *The Toca Producers*, 107 F.E.R.C. ¶ 61,009 (2004).

43. *Toca Producers v. FERC*, No. 04-1135 (D.C. Cir. filed Apr. 16, 2004).

44. *AES Ocean Express LLC*, 107 F.E.R.C. ¶ 61,276 (2004).

45. *Id.* at 62,280.

46. 107 F.E.R.C. ¶ 61,276, at 62,281.

made to FGT's tariff.<sup>47</sup> The June 18 Order also set for hearing and settlement judge proceedings for FGT's proposed 6% hourly flow requirement and the minimum temperature requirement of eighty degrees Fahrenheit contained in the Interconnection Agreement.<sup>48</sup> FGT reached an agreement with AES resolving the 6% hourly flow issue, wherein the flow rate may be at a rate between 4.17% per hour up to 6% for new service transportation requests.<sup>49</sup> On December 22, 2004, the Commission approved the partial settlement agreement.<sup>50</sup> On December 16, 2004, FGT filed a settlement resolving the temperature issue, which permits a range of different temperatures at certain points on the FGT system, with a minimum temperature of sixty-five degrees Fahrenheit required at the inlet into the FGT mainline. The Commission has not yet acted on this settlement.

II. STATE OF THE NATURAL GAS INDUSTRY CONFERENCE, DOCKET NO. PL04-17-000, STAFF REPORT ON NATURAL GAS STORAGE, DOCKET NO. AD04-11-000

On September 30, 2004, the Commission issued a notice that it would hold a conference on October 21, 2004, to engage industry members and the public in a dialogue about policy issues facing the natural gas industry and the Commission's future regulation of the industry.<sup>51</sup> The Commission had held these industry conferences in each of the prior two years; this year's conference focused on underground storage and other factors that differentiate regional natural gas deliverability and market needs.

Concurrent with issuance of the notice, the FERC issued a Staff Report, "Current State of and Issues Concerning Underground Natural Gas Storage."<sup>52</sup> The key findings of the report were:

- Under average conditions and from a nationwide perspective, storage appears to be adequate to meet seasonal demand; however, continued commodity price volatility indicates that more storage may be appropriate.
- Storage may be the best way of managing gas commodity price, so the long-term adequacy of storage investment depends on how much price volatility customers consider 'acceptable.'
- A study performed by the National Petroleum Council indicates that there may be a need in North America for 700 Bcf of new storage between now and 2025. Another study, by [t]he INGAA Foundation, concludes that 651 Bcf of new storage may be needed in the United States and Canada by 2020. In addition, there may be certain region-specific (*e.g.*, Southwest, New England) needs for new storage.
- Geology, economics, and environmental impacts may stall development and could jeopardize achieving forecasted capacity needs.

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47. *Id.*

48. 107 F.E.R.C. ¶ 61,276, at 62,286.

49. *Fla. Gas Transmission Co.*, 109 F.E.R.C. ¶ 61,357 (2004).

50. *Id.*

51. FERC, Notice of Public Conference, *State of the Natural Gas Industry Conference and Staff Report on Natural Gas Storage*, 69 Fed. Reg. 59,917 (2004).

52. FED. ENERGY REGULATORY COMM'N, CURRENT STATE OF AND ISSUES CONCERNING UNDERGROUND NATURAL GAS STORAGE, Docket No. AD04-11-000 (2004).

- Reengineering of existing storage fields is underway in order to improve working gas capability – application of new engineering techniques can help to ensure that development of new fields stays on track.
- Four key methods that market participants use to value storage (*e.g.*, cost of service; least-cost planning; seasonal valuation, or intrinsic; and, option-based valuation, or extrinsic) do not always reach the same result because they are based on differing views of the need and reasons for storage.
- Storage projects in certain geographic areas (*e.g.*, Southwest) often fail the Commission's market-based rates tests.
- Creative ratemaking approaches may encourage storage development.
- Creative certificate and policy choices may also encourage storage development by reducing costs and permitting additional opportunities to generate revenues.<sup>53</sup>

At the October 21 conference, panelists representing independent storage operators urged the FERC to allow for market-based rates to prevent what they claim to be unfair competition from storage operators with existing ratepayers. Pipeline operators argued that the FERC's existing policy for pricing capacity expansions should allow for a broader interpretation of expansion benefits to include reliability and decreased volatility of commodity prices. By attributing greater benefits to an expansion, the expansion could qualify for rolled-in rate treatment. All parties agreed on the need for additional storage and pipeline capacity, and the need for the FERC to implement pricing policies to encourage this development.

### III. UPDATE ON CREDITWORTHINESS ISSUES

On February 12, 2004, the Commission issued a notice of proposed rulemaking governing "Creditworthiness Standards for Interstate Natural Gas Pipelines" (NOPR).<sup>54</sup> The NOPR proposed to amend Commission regulations to require interstate natural gas pipelines to follow standardized procedures for determining the creditworthiness of their shippers.<sup>55</sup> The NOPR incorporates by reference the ten procedural creditworthiness standards promulgated by the North American Energy Standards Board's (NAESB) Wholesale Gas Quadrant (WGQ).<sup>56</sup> Additionally, the NOPR contains proposed substantive standards

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53. *Id.* at 1.

54. Notice of Proposed Rulemaking, *Creditworthiness Standards for Interstate Natural Gas Pipelines*, F.E.R.C. STATS. & REGS. ¶ 32,573, 69 Fed. Reg. 8587 (2004) [hereinafter *Creditworthiness Standards*]. The Commission stated that "[t]he proposed regulations are intended to promote consistent practices among interstate pipelines and provide shippers with an objective and transparent creditworthiness evaluation." *Id.* at 32,021.

55. *Id.* Prior to this, the Commission established terms and conditions relating to the credit requirements of obtaining open access service on interstate pipelines in individual proceedings.

56. At the Commission's request, on November 6, 2002, the NAESB WGQ's Business Practice Subcommittee (BPS) initiated the standards development process. BPS's efforts culminated in a recommendation that twenty-four standards be adopted. The WGQ Executive Committee only adopted ten of the procedural creditworthiness standards because it was unable to reach a consensus on the substantive standards. On June 16, 2003, as supplemented on June 25, 2003, the NAESB filed a progress report in Docket No. RM96-1-000. See Report of the Natural Gas Regulation Committee, 25 ENERGY L.J. 217, 241-42, 244-46



developed by the Commission covering a range of creditworthiness issues.<sup>57</sup> Various comments on the NOPR have been submitted by all segments of the energy industry. The Commission to date has not issued a final rule. A few of the proposed substantive creditworthiness standards are discussed below.

#### *A. Criteria for Determining Creditworthiness*

The NOPR standardizes the documents and information shippers have to provide to the pipelines to establish their credit.<sup>58</sup> Further, the proposal requires each pipeline to develop an objective set of criteria in its tariff to evaluate a shipper's creditworthiness.<sup>59</sup>

#### *B. Collateral Requirements for Non-Creditworthy Shippers*

"[T]he Commission propose[d] to continue its traditional policy of requiring no more than the equivalent of three months' worth of reservation charges" for non-creditworthy shippers requesting service on existing pipeline facilities.<sup>60</sup> The Commission, however, seeks comments on whether pipelines should be allowed "to require a non-creditworthy shipper to provide an advance payment for one month of service. . . . [and] then require the shipper to post collateral to cover the additional two months necessary to terminate the shipper's contract."<sup>61</sup> Comment is sought as to whether the Commission "should permit pipelines to take a shipper's creditworthiness and the extent of its collateral into account when the pipeline is allocating available firm capacity among various bidders."<sup>62</sup>

For mainline construction, pipelines and shippers should negotiate collateral requirements in their precedent agreements "so that any disputes . . . [may] be resolved in the pipeline's certificate proceeding."<sup>63</sup> "[C]onsistent with its current policy," the Commission proposes to "allow pipelines to require collateral up to the full cost" for lateral line construction and such a requirement should be

(2004).

57. *Creditworthiness Standards*, *supra* note 55, at 32,023. The Commission indicated that the NOPR provisions are minimum requirements but that pipelines can still opt to propose more lenient tariff provisions. *Id.* at 32,024. The proposal amends sections 284.8 and 284.12 (18 C.F.R. §§ 284.8, 284.12 (2004)) of the Commission's regulations governing capacity release and business practices and electronic communications.

58. The purpose of this proposal is to "increase a shipper's ability to obtain and retain service on multiple pipelines by ensuring that the shipper would not have to assemble different packages of documentation for each pipeline." *Creditworthiness Standards*, *supra* note 55, at 32,024.

59. The NOPR does not impose a uniform set of standards for pipelines to evaluate shippers' creditworthiness, but the Commission seeks comments on whether it should adopt such criteria and if so, the criteria that should be used. *Id.* at 32,026.

60. *Creditworthiness Standards*, *supra* note 55, at 32,027.

61. *Id.* The Commission indicated that such an approach would recognize that non-creditworthy customers in other industries are frequently required to tender advance payment for services. *Creditworthiness Standards*, *supra* note 55, at 32,027.

62. *Id.* at 32,028. For instance, the Commission explained that a ten-year bid by a creditworthy shipper could be considered more valuable than a twenty-five year bid by a non-creditworthy shipper. Comments on this issue are to address whether such a proposal is consistent with open access service and practical methods by which pipelines could apply non-discriminatory criteria. *Creditworthiness Standards*, *supra* note 55.

63. *Id.* at 32,028–29. With respect to construction projects, the Commission is continuing its policy of allowing larger collateral requirements, but "under no circumstance, should the collateral exceed the shipper's proportionate share of the project's cost." *Creditworthiness Standards*, *supra* note 55, at 32,029.

included in a pipeline's tariff.<sup>64</sup>

"The Commission [also] requests comment on whether it should adopt standards governing collateral for loaned gas with respect to imbalances [and for services allowing] the borrowing of gas, such as park and loan services."<sup>65</sup> Under the NOPR, the pipelines would be required "to offer shippers the opportunity to earn interest on collateral payments."<sup>66</sup>

On June 17, 2004, the Commission issued an order on rehearing in *Gulf South Pipeline Company*,<sup>67</sup> (Gulf South) which, among other issues, granted in part rehearing with respect to certain issues related to the pipeline's creditworthiness standards on imbalances.<sup>68</sup> In a compliance filing, Gulf South proposed that for new non-creditworthy shippers, the value of imbalances would be calculated in its credit limit "based on ten percent of a shipper's estimated monthly usage multiplied by the estimated imbalance rate."<sup>69</sup> In its rehearing request, Calpine Energy Services, L.P. (Calpine) argued that a "ten percent level could lead to excessive collateral requirements, [and maintained that a] review of the impact of resolving imbalance amounts through trades . . . shows that one percent is an appropriate level."<sup>70</sup> The Commission granted rehearing in part, requiring Gulf South "to provide information and rationale in further support of the standard to be adopted."<sup>71</sup>

The Commission granted rehearing of another issue raised by Calpine directing Gulf South to clarify that its "interest in security on imbalance gas is rightfully limited to the level reflective of imbalances actually owed to Gulf South."<sup>72</sup> Also, the Commission granted rehearing of the issue raised by Calpine that Gulf South's "operations of cash-in/cash-out account should reflect the collateral recoveries that benefit Gulf South in order to prevent financial relief appropriately credited to shippers from being credited to Gulf South's benefit."<sup>73</sup>

### C. Timeline for Suspension and Termination of Service

Under the NOPR, "a pipeline may suspend . . . service upon a shipper's default on its obligations or upon finding that a shipper is no longer creditworthy. When a shipper is no longer creditworthy . . . [or is in default of its obligations, the pipeline must give the shipper] at least five business days

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64. *Id.* at 32,029. The Commission pointed out that the likelihood of the pipeline remarketing capacity on a lateral line is far less than for mainline construction. *Creditworthiness Standards*, *supra* note 55. at 32,029-30.

65. *Id.* at 32,030.

66. *Creditworthiness Standards*, *supra* note 55, at 32,031.

67. *Gulf S. Pipeline Co.*, 107 F.E.R.C. ¶ 61,273 (2004). On July 19, 2004, Gulf South filed a rehearing request of the June 17 Order, which is pending before the Commission.

68. *Id.* at 62,244-45.

69. 107 F.E.R.C. ¶ 61,273, at 62,244.

70. *Id.*

71. 107 F.E.R.C. ¶ 61,273, at 62,244. The Commission noted that, as stated in the NOPR, "a shipper could be required to provide no collateral for the first month, and then be required to provide collateral based on its first month's imbalance in the second month. After that, the amount of collateral could be updated as a track record is developed." *Id.*

72. *Gulf S. Pipeline Co.*, 107 F.E.R.C. ¶ 61,273, 62,244 (2004).

73. *Id.* at 62,245.

within which to provide advance payment for one month's service," and thirty days to satisfy the collateral requirement.<sup>74</sup> If "a shipper either defaults or fails to provide the required collateral, pipelines would need to provide the shipper and the Commission with 30 days notice prior to terminating the shipper's contract."<sup>75</sup>

#### *D. Capacity Release*

Consistent with its existing policy, the NOPR requires a releasing shipper to "apply the same creditworthiness requirements to a replacement shipper as it would if that shipper . . . [was] outside of the capacity release process."<sup>76</sup> Pursuant to the NOPR, a pipeline may terminate a release of capacity to the replacement shipper if the releasing shipper's service agreement is terminated. However, the pipeline must give the replacement shipper "an opportunity to continue receiving service if it agrees to pay, for the remaining term of the replacement shipper's contract, the lesser of: (1) the releasing shipper's contract rate; (2) the maximum tariff rate applicable to the releasing shipper's capacity; or (3) [another] rate that is acceptable to the pipeline."<sup>77</sup>

"With respect to segmented releases . . . [a] replacement shipper would have the right to continue service if it agreed to take the full contract path of the releasing shipper at the rate paid by the [default-] releasing shipper."<sup>78</sup> Also, the Commission proposes to require pipelines to establish procedures that permit "releasing shipper[s] to have the option of whether to: (1) require bidders for its released capacity to pre-qualify under the pipeline's creditworthiness standards; or (2) waive the prequalification requirement and post a bond or assume liability for the usage charge in the event of the replacement shipper's default."<sup>79</sup>

#### IV. THE FERC'S FORCE MAJEURE RESERVATION CHARGE CREDITING POLICY

In 2004, the Commission considered its policy relating to crediting of reservation charges in force majeure situations. The Commission reaffirmed its policy that pipelines should only be required to provide a partial reservation charge credit to shippers for transportation shortfalls resulting from a force majeure event. The policy, outlined in Opinion No. 406,<sup>80</sup> requires that when firm service is curtailed due to events outside of a pipeline's control, a pipeline and its firm shippers should share the risks associated with curtailment through partial reservation charge credits. This partial revenue crediting approach stands in contrast to required full reservation charge credits when there are service interruptions resulting from actions within a pipeline's control. The rationale for

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74. *Creditworthiness Standards*, *supra* note 55, at 32,032. Pursuant to the NOPR, a pipeline could not bill a firm shipper for suspended transportation service. The pipeline can opt "to provide service and sue the shipper for consequential, unmitigated damages caused by its contractual breach." *Id.*

75. *Creditworthiness Standards*, *supra* note 55, at 32,032.

76. *Id.* at 32,033.

77. *Creditworthiness Standards*, *supra* note 55, at 32,034.

78. *Id.* at 32,034.

79. *Creditworthiness Standards*, *supra* note 55, at 32,035.

80. *Tenn. Gas Pipeline Co.*, 76 F.E.R.C. ¶ 61,022 (1996), *order on reh'g*, 80 F.E.R.C. ¶ 61,070 (1997).

the force majeure crediting policy is that neither the pipeline nor the shipper is responsible for the interruption in scheduled deliveries due to a force majeure event, thereby making it unfair for either side to bear the entire cost.<sup>81</sup> In contrast, in non-force majeure circumstances, the pipeline controls its operations and the FERC, therefore, generally requires full reservation charge credits to shippers if the pipeline fails to provide at least 98% of scheduled deliveries.<sup>82</sup>

In March 2004, the FERC clarified two forms of acceptable shared risk allocation in an order addressing tariff revisions of the Natural Gas Pipeline Company of America (Natural).<sup>83</sup> Natural proposed to structure its shared risk allocation by granting a partial reservation charge credit in a force majeure situation either (1) after ten days had elapsed following a force majeure event, or (2) beginning after “the date Natural has or should have, in the exercise of due diligence, overcome the *force majeure* event, whichever occur [sic] first.”<sup>84</sup> The Indicated Shippers objected to this allocation, arguing instead that the credit should be structured similar to Tennessee’s allocation in Opinion No. 406, where partial credits are calculated from the onset of the shortfall based on the pipeline’s “return on equity and associated incomes taxes for the undelivered [volume of gas].”<sup>85</sup> The Commission approved Natural’s approach, noting that it was similar to an approach that Texas Eastern used,<sup>86</sup> but required Natural to increase the credit amount to full reservation charge credits once the applicable time period had passed.<sup>87</sup> In a later *Natural* order, the Commission also clarified the situations that constitute a force majeure event.<sup>88</sup> The Commission reiterated that unscheduled maintenance is a force majeure event, rejecting Indicated Shippers’ argument that there essentially is no such thing as unscheduled maintenance. Indicated Shippers had argued that for purposes of the FERC’s force majeure policy, unscheduled maintenance should be associated with another force majeure event before it can be considered “unscheduled,” thereby qualifying as a no-fault interruption of transportation service.<sup>89</sup> Citing *El Paso Natural Gas Co.*<sup>90</sup> and Opinion No. 406 as precedent, the Commission determined that unscheduled maintenance will continue to be viewed as a force majeure event on its own, leaving Indicated Shippers to challenge specific instances of maintenance as scheduled or unscheduled as those situations arise.

The Commission also considered the scope of force majeure events in a

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81. *Id.* at 61,088–89.

82. *Natural Gas Pipeline Co. of Am.*, 106 F.E.R.C. ¶ 61,310, 62,210 (2004) (citing *Tenn. Gas Pipeline Co.*, 76 F.E.R.C. ¶ 61,022 (1996)). Natural proposed a reservation charge credit threshold of 95%. The FERC refused to approve it, citing Tennessee’s similar proposal in Opinion No. 406 and stating that it saw no reason to approve a lower percentage than the 98% approved for Tennessee.

83. 106 F.E.R.C. ¶ 61,310.

84. *Id.* at 62,210 (quoting Natural’s proposed General Terms & Conditions, section 5.2(c)(2)(v)).

85. *See Tenn. Gas Pipeline Co.*, 76 F.E.R.C. 61,022, 61,089 (1996).

86. *Tex. E. Transmission Corp.*, 62 F.E.R.C. ¶ 61,015 (1993).

87. *Natural Gas Pipeline Co. of Am.*, 106 F.E.R.C. ¶ 61,310, 62,211 (2004).

88. *Natural Gas Pipeline Co. of Am.*, 108 F.E.R.C. ¶ 61,170 (2004).

89. *Id.* at 62,024.

90. *El Paso Natural Gas Co.*, 105 F.E.R.C. ¶ 61,262 (2003). In the *El Paso* order, the FERC rejected El Paso’s argument that it should be permitted to issue partial credits for both scheduled and unscheduled maintenance due to its limited ability to perform planned maintenance on its system without interrupting service. *Id.*

FGT proceeding. There, the Commission narrowed FGT's proposed definition of force majeure circumstances to exclude repairs or alterations to machinery and pipe, planned outages on the shipper's facility or transporter's pipeline systems, and the inability to deliver gas.<sup>91</sup> The Commission required these changes because it found that these listed events were expressly within FGT's control or could be read as being expressly within FGT's control.<sup>92</sup>

V. D.C. CIRCUIT REMAND OF THE FERC'S COLORADO GAS INTERSTATE GAS COMPANY DISCOUNT POLICY ORDER AND REQUEST FOR COMMENTS REGARDING WILLISTON BASIN INTERSTATE PIPELINE COMPANY, DOCKET NO. RP00-463-006

On June 1, 2004, the Commission issued an Order on Remand concerning its Colorado Gas Interstate Gas Company/Granite State Transmission Company (CIG/GS) policy relating to selective discounting of gas transportation rates.<sup>93</sup> Under that policy, as first articulated in *Colorado Interstate Gas Co. (CIG)*,<sup>94</sup> "if a pipeline is discounting its primary capacity at a point, a shipper that segments to that point or uses that point on a secondary basis should also receive that discount if it is similarly situated to the shipper receiving the discount."<sup>95</sup> In *Granite State Transmission Co. (Granite State)*, the Commission amended its holding in *CIG* to require pipelines to "process shipper requests to retain discounts in no longer than two hours from the time the request is submitted."<sup>96</sup>

These cases modified the Commission's previous policy, as stated in *El Paso Natural Gas Co. (El Paso)*,<sup>97</sup> concerning how to give effect to the Commission's ruling that firm shippers had the right to use, on a secondary basis, receipt and delivery points other than the primary points listed in their contracts. In *El Paso*, the Commission held that if the pipeline's contract with the releasing shipper limited its discount to its primary points, the pipeline could require the releasing shipper to pay the maximum rate whenever its replacement shipper used a different point.

In the June 1 Order on Remand, the Commission requested comments from the parties on whether the Commission should reaffirm its general CIG/GS policy "concerning retention of discounts when secondary points are used, return to its previous policy as set forth in *El Paso Natural Gas Co.* or adopt some other"<sup>98</sup> alternative policy, such as one that would "permit a releasing shipper to retain its discount if the release is for one month or less."<sup>99</sup> The Commission also sought "comments on the extent to which the CIG/Granite State policy . . . undercut the benefits of selective discounting for captive customers;"<sup>100</sup> whether,

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91. *Fla. Gas Transmission Co.*, 107 F.E.R.C. ¶ 61,074, 61,245 (2004).

92. *Id.*

93. *Williston Basin Interstate Pipeline Co.*, 107 F.E.R.C. ¶ 61,229 (2004).

94. *Colo. Interstate Gas Co.*, 95 F.E.R.C. ¶ 61,321 (2001).

95. 107 F.E.R.C. ¶ 61,229, at 61,987.

96. *Granite State Transmission Co.*, 96 F.E.R.C. ¶ 61,273, 62,037 (2001).

97. *El Paso Natural Gas Co.*, 62 F.E.R.C. ¶ 61,311 (1993).

98. *Id.* at 61,990.

99. 62 F.E.R.C. ¶ 61,311, at 61,989.

100. *Id.*

given its "limitations on the right of the releasing shipper to retain its discount . . . the CIG/Granite State policy significantly increase[s] the opportunities for arbitrage;"<sup>101</sup> whether "there is less . . . incentive under the CIG/Granite State policy for pipelines to offer discounts to attract additional throughput;"<sup>102</sup> "how the CIG/Granite States policy has affected their release of capacity;"<sup>103</sup> and "whether the impact of the CIG/Granite States policy is different on reticulated systems than on long line systems."<sup>104</sup>

The Commission's request resulted in the filing of comments by ten parties, six of which represented interstate pipeline interests, including INGAA, and four by parties which were marketers, producers, and diversified energy companies. The pipeline commenters generally requested the Commission to reestablish the *El Paso* policy, although Kinder Morgan Interstate Pipelines (Kinder Morgan) argued for a modification of CIG/GS so pricing provisions of a contract between an interstate pipeline and its firm service customer that cover alternate point pricing are honored. ProLiance Energy, LLC, a marketer, argued for expansion of the CIG/GS policy to allow shippers to use their discounts at any points within the capacity for which they have paid. Dominion Resources, a diversified energy company, and NiSource Distribution Companies stated that the CIG/GS policy appears to balance more closely the competing concerns of pipelines and shippers than did the *El Paso* policy, but that the CIG/GS policy should be clarified to increase certainty. Only BP America Production Company supported the existing CIG/GS policy. No party supported the "one month or less" alternative on which the Commission requested comments.

Among the arguments raised against the CIG/GS policy are that it forces pipelines to provide services at rates that do not recover the pipelines' cost of service because they are less than the maximum just and reasonable rates; it alters rates without evidence that pipelines have failed to grant discounts where economically justified; it illegally shifts the section 5 burden of proof to the pipeline to show that its existing rates are just and reasonable; and it requires pipelines to grant discounts not justified by competitive considerations in order to avoid litigation costs.

Arguments that the CIG/GS policy, or some variant thereof, should be affirmed include that the rebuttable presumption feature of that policy is flexible enough to address the specific competitive situation on any given pipeline. Proponents of the CIG/GS policy also argued that the *El Paso* policy is unacceptable because that policy provides the pipeline total discretion as to whether to grant a discount at a specific point or not. They maintained that a return to *El Paso* would result in reduced competition on the pipeline and a further reduction in the value of discounted firm capacity for shippers.

With regard to the specific questions on which the Commission requested comment, pipeline commenters generally argued that the CIG/GS policy significantly increases the opportunities for arbitrage, creates less incentive for pipelines to offer discounts, and tends to have a different or more significant

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101. 62 F.E.R.C. ¶ 61,311, at 61,989.

102. *Id.*

103. *El Paso Nat. Gas Co.*, 62 F.E.R.C. ¶ 61,311, 61,990 (1993).

104. *Id.* at 61,990.

impact on reticulated systems as opposed to long line systems. Shippers usually took the opposing view, although views on these issues did not split uniformly along pipeline/shipper lines. Kinder Morgan stated that the impact of the CIG/GS policy would not necessarily depend on the reticulated nature of the system but is likely to be greatest on an interstate pipeline that serves several different supply and market regions, with diverse competitive and market conditions which lead to pricing differentiation by geographical region. Dominion Resources argued that confusion concerning the mechanics of the CIG/GS policy has had a chilling effect on discounting, but that this could be alleviated if the Commission provided more guidance concerning such issues as the definition of “similarly situated.” Dominion Resources also argued that shippers have been discouraged from engaging in capacity release because some pipelines continue to apply the terms of their existing contracts prohibiting discount portability.

## VI. REGULATORY DEVELOPMENTS ON THE OUTER CONTINENTAL SHELF (OCS) IN 2004

### A. *Williams Gas Processing – Gulf Coast Co. v. FERC*

On July 13, 2004, the U.S. Court of Appeals for the D.C. Circuit issued an opinion vacating and remanding the Commission’s orders granting a complaint filed by Shell Offshore Inc. (SOI) against Transcontinental Gas Pipe Line Corporation (Transco) and its gathering affiliate, Williams Gas Processing Gulf Coast Company, L.P. (WGP) alleging “concerted action” between the affiliates that frustrated the Commission’s ability to regulate Transco.<sup>105</sup> The Commission had determined that Transco and WGP had acted in concert and that “[b]y demanding a monopolistically egregious rate in conjunction with anti-competitive terms and conditions of service . . . the single entity, Transco/WFS [predecessor in interest to WGP], frustrated the Commission’s regulation over the rates and services provided on Transco.”<sup>106</sup> As a result, the Commission reasserted jurisdiction over gathering facilities sold by Transco to WGP and established a just and reasonable gathering rate for Shell.

The court found that the Commission misapplied the two-part *Arkla Gathering* test by failing to show that the concerted action frustrated the Commission’s ability to regulate Transco and instead prematurely pierced the corporate veil to analyze the actions of WPS and Transco as one entity.<sup>107</sup> The court concluded that the Commission’s “line of reasoning founders as it adopts as its first premise (WFS is Transco) the *Arkla Gathering* test’s ultimate conclusion—that the corporate form may be set aside.”<sup>108</sup>

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105. *Williams Gas Processing – Gulf Coast Co. v. FERC*, 373 F.3d 1335 (D.C. Cir. 2004). The FERC established a two-part test in *Arkla Gathering Servs. Co.*, 67 F.E.R.C. ¶ 61,257, 61,871 (1994): (1) the concerted action between the pipeline and its gathering affiliate which (2) frustrates the Commission ability to regulate the jurisdictional interstate pipeline.

106. *Shell Offshore Inc.*, 100 F.E.R.C. ¶ 61,254, 61,914 (2002).

107. *Williams Gas Processing*, 375 F.3d at 1343.

108. *Id.*

VII. REHEARING ORDERS ON STANDARDS OF CONDUCT FOR TRANSMISSION PROVIDERS (ORDER NOS. 2004-A, 2004-B, AND 2004-C)

On April 16, August 2, and December 21, 2004, respectively, the Commission issued orders on rehearing and clarification of its Standards of Conduct for Transmission Providers, Order No. 2004.<sup>109</sup> Order No. 2004 adopted standards of conduct for transmission providers “that apply uniformly to interstate natural gas pipelines and public utilities (jointly referred to as Transmission Providers) that [were] . . . subject to the [former] gas standards of conduct in Part 161 of the Commission’s regulations . . . [or the former] electric standards of conduct in Part 37 of the Commission’s regulations.”<sup>110</sup> The proposed standards of conduct are “designed to prevent Transmission Providers [interstate natural gas pipeline and public electric utilities] from giving undue preferences to any of their Energy Affiliates to ensure that transmission is provided on a non-discriminatory basis.”<sup>111</sup> Due to space constraints, this article provides a catalogue list of issues addressed in the rehearing orders, as provided by the orders themselves. Order No. 2004-A:

(1) clarify[d] the definition of Energy Affiliate; (2) further codify[d] the definition of “Marketing Affiliate;” (3) clarify[d] which Field and Maintenance employees a Transmission Provider may share with its Energy Affiliates; (4) clarify[d] that a Transmission Provider may share with its Energy Affiliates information necessary to maintain the operations of the transmission system; (5) codify[d] the exception that permits a Transmission Provider to share senior officers and directors with its Marketing and Energy Affiliates; (6) codify[d] the exception that permits a Transmission Provider to share the risk management function with its Marketing and Energy Affiliates; (7) codify[d] that a Transmission Provider may share information with certain employees it shares with its Marketing and Energy Affiliates; and (8) defer[ed] the implementation date to September 1, 2004.<sup>112</sup>

Chief among the clarifications made in Order 2004-B were that:

(1) local distribution companies (LDCs) may release or acquire capacity in the capacity release market without becoming Energy Affiliates; (2) the Energy Affiliate exemption for LDCs extends to LDCs serving state-regulated load at cost-based rates that acquire interstate transmission capacity to purchase and resell gas only for on-system sales; (3) an LDC division of an electric public utility Transmission Provider will not be treated as an Energy Affiliate if it qualifies for the LDC exemption under § 358.3(d)(6)(v); (4) LDCs that otherwise qualify for the LDC exemption under § 358.3(d)(6)(v) do not change their status by responding to emergencies; however, each emergency activity shall be posted; (5) natural gas processors do not become Energy Affiliates by virtue of purchasing and transporting gas on affiliated Transmission Providers for plant thermal reduction purposes; (6) processors, gatherers, intrastate pipelines and Hinshaw pipelines may

109. Order No. 2004, *Standards of Conduct for Transmission Providers*, F.E.R.C. STATS. & REGS. ¶ 31,155, 68 Fed. Reg. 69,134 (2003) (to be codified at 18 C.F.R. pts. 37, 161, 250, 284, 358) [hereinafter Order No. 2004], *order on reh’g and clarification*, Order No. 2004-A, *Standards of Conduct for Transmission Providers*, F.E.R.C. STATS. & REGS. ¶ 31,161, 69 Fed. Reg. 23,562 (2004) [hereinafter Order No. 2004-A], *further order on reh’g and clarification*, Order No. 2004-B, *Standards of Conduct for Transmission Providers*, FERC STATS. & REGS. ¶ 31,166, 69 Fed. Reg. 48,371 (2004) [hereinafter Order No. 2004-B], *further order on reh’g and clarify*, Order No. 2004-C, *Standards of Conduct for Transmission Providers*, F.E.R.C. STATS & REGS. ¶ 31,172 (2005), 70 Fed. Reg. 284 (to be codified at 18 C.F.R. § 358).

110. Order No. 2004, *supra* note 110, at ¶ 30,817.

111. *Id.* at ¶ 30,818.

112. Order No. 2004-A, *supra* note 110, at ¶ 31,175.



purchase gas for operational purposes and make *de minimus* sales as required to remain in balance without becoming Energy Affiliates; (7) service companies that do not engage in any activities described in §§ 358.3(d)(1), (2), (3) or (4) on their own behalf and whose employees assigned, dedicated or working on behalf of a particular entity are subject to the Standards of Conduct as if they were directly employed by that entity are not Energy Affiliates; (8) an affiliate that purchases natural gas solely for its own consumption is not an Energy Affiliate by virtue of those purchases; (9) § 358.4(a)(5) does not prohibit senior officers who are Transmission Function Employees from receiving transmission-related information; (10) Transmission Providers need not post the identity of shared physical field infrastructure, such as substations, that do not house any employees; (11) posted logs of discretionary waivers need not disclose customer names; (12) all officers of the Transmission Provider as well its employees with access to transmission information or information concerning gas or electric purchases, sales or marketing must be trained concerning the requirements of the Standards of Conduct; (13) Transmission Providers need not post notice of or transcribe scoping meetings for purposes of the Standards of Conduct; and (14) a Transmission Provider that has a division that operates as a functional unit is not required to maintain separate books and records for that unit.<sup>113</sup>

Finally, Order 2004-C:

(1) grant[ed] rehearing by allowing [LDCs] to participate in hedging related to on-system sales and still qualify for exemption from Energy Affiliate status; (2) den[ied] rehearing regarding exemptions for electric local distribution companies; (3) clarify[ied] the duties of Transmission Function Employees; (4) provid[ed] additional clarification and grant[ed] partial rehearing regarding information to be posted on the Internet or [the Open-Access, Same-Time Information System (OASIS)]; (5) den[ied] rehearing regarding the timing of the applicability of the Standards of Conduct to newly formed Transmission Providers; (6) and ma[de] miscellaneous corrections to the regulatory text.<sup>114</sup>

#### VIII. CRITICAL ENERGY INFRASTRUCTURE INFORMATION, DOCKET NOS. RM02-4, PL02-1

In response to the September 11, 2001 attacks, and based on the concern that terrorists might obtain critical energy infrastructure information (CEII) concerning natural gas pipelines, generating facilities, transmission lines, and hydroelectric facilities, the Commission adopted regulations limiting access to CEII to those participating in the Commission's proceedings who have made an application to a CEII Coordinator (Commission employee) to receive CEII.<sup>115</sup> The Commission also permitted companies that were subject to various mandatory disclosure requirements under the Commission's regulations (including part 157) to omit any CEII from the information that it makes available to the public and to provide in place of such information a statement describing the withheld information and referring the public to the procedures for

113. Order No. 2004-B, *supra* note 110, at ¶ 31,241.

114. Order No. 2004-C, *supra* note 110, at ¶ 31,313.

115. Order No. 630, *Critical Energy Infrastructure Information*, F.E.R.C. STATS. & REGS. ¶ 31,140, 68 Fed. Reg. 9857 (2003) (to be codified at 18 C.F.R. pts. 375 and 378), *order on reh'g*, Order No. 630-A, *Critical Energy Infrastructure Information*, F.E.R.C. STATS. & REGS. ¶ 31,147, 68 Fed. Reg. 46,456 (2003) (to be codified at 18 C.F.R. pt. 388); Order No. 643, *Amendments To Conform Regulations with Order No. 630 (Critical Energy Infrastructure Information)*, F.E.R.C. STATS. & REGS. ¶ 31,149, 68 Fed. Reg. 52,089 (2003) (to be codified at 18 C.F.R. pts. 4, 16, 141, 157).

challenging a CEII designation.

The Commission also promised to review its procedures within six months to achieve a balance between the due process rights of interested persons and its responsibility to protect the public safety by ensuring that access to CEII does not facilitate acts of terrorism. On February 13, 2004, the Commission issued a notice soliciting public comment on its procedures dealing with CEII.<sup>116</sup> After receiving comments, the Commission issued Order No. 649 amending 18 C.F.R. § 388.113 and clarifying certain other points regarding CEII.<sup>117</sup>

In Order No. 649, the Commission rejected a suggestion that the Commission classify CEII by pointing out that even prior to its CEII rules the Commission permitted filers to designate information filed with the Commission for non-public treatment, subject to a requesting party making a Freedom of Information Act (FOIA) request. The Commission found that its CEII procedures were much easier to use than the FOIA. However, the Commission clarified that it would promptly move to have the status of information changed if the Commission staff notices that information has been improperly classified as CEII and the Commission has established guidelines for classifying CEII.

The Commission did reconsider whether project boundary maps should be CEII. It concluded that such maps should be treated as "non-Internet public" information rather than being classified as CEII. On the other hand, the Commission rejected the suggestion that those submitting material as CEII should no longer be permitted to comment on a request that the material be released. The Commission found that it was useful to have comments from the submitters of information.

Upon request of the Department of Interior, the Commission clarified that once a federal agency has been granted access to CEII in a Commission docket, it will be entitled to receive subsequent CEII in that docket, subject only to the federal agency requesting the specific material.

The Commission's rules have permitted owners/operators to obtain CEII, but not the owner/operator's agents. The Commission amended its rule to allow agents for owner/operators to obtain data with the written authorization of the owner/operator.<sup>118</sup> At the urging of several commenters, the Commission agreed to re-examine the effectiveness of its rules again within one year, based on the then-prevailing world situation.

#### IX. PRICE DISCOVERY IN NATURAL GAS AND ELECTRIC MARKETS AND NATURAL GAS PRICE FORMATION

As reported in last year's Committee report,<sup>119</sup> since early 2003 the FERC has been actively engaged in monitoring and reforming the process by which natural gas price indices are created. The FERC's activities have included encouraging more voluntary "reporting [of] transaction data to index

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116. Notice, *New York Electric & Gas Corporation, et al.; Electric Rate and Corporate Filings*, 69 Fed. Reg. 8636 (2004).

117. Order No. 649, *Critical Energy Infrastructure Information*, F.E.R.C. STATS. & REGS. ¶ 31,167, 69 Fed. Reg. 48,386 (2004) (to be codified at 18 C.F.R. pt. 388).

118. Conservation of Power and Water Resources, 18 C.F.R. § 388.113(d) (2004).

119. Report of the Natural Gas Regulation Committee, 25 ENERGY L.J., 217, 236-38 (2004).

developers”, creating a more comprehensive reporting culture.<sup>120</sup> The Commission’s means was the adoption of standards to be used by both those reporting transaction data to index developers and those developing price indices and conducting industry surveys to assess the level of reporting and the confidence in the price reporting mechanism.<sup>121</sup>

The Commission continued its vigilance on this issue in 2004, starting with an industry survey in March, followed by a May 5, 2004 comprehensive staff report,<sup>122</sup> and a staff technical conference on June 25, 2004. The conference was intended “to evaluate progress in the current voluntary system of price reporting and index development, to [discuss the] recommendations made in the staff report, including specifically [those addressing] the use of price indices in jurisdictional tariffs, and to [explore] options for future Commission action.”<sup>123</sup>

Through conference dialogue and as a result of its March survey, the Commission learned that the volume of transactions on which indices are based has increased from 2003 levels and that the process is much improved, especially in three key areas: “reporting by a source independent of trading, having an annual independent review [of internal processes used to report data] . . . and having a public code of conduct.”<sup>124</sup> Additionally, information provided by index publishers has increased. Finally, a notable increase in confidence in the indices and the index development process was reported.

As a result, the Commission issued an order in November 2004.<sup>125</sup> The Commission announced its intention to continue to monitor issues surrounding price index reporting and development, but to take no further action at that time, such as mandating reporting. The Commission directed its staff to “monitor the level and quality of reporting to index developers and the adherence by price reporting entities to the standards of the Policy Statement, as well as the quality of price indices and the adherence of price index developers to the standards of the Policy Statement.”<sup>126</sup>

In addition, the Commission used the November 2004 Order to review the price index developers’ responses to key components of the Policy Statement standards, indicating ten price index developers have adequately met the standards. Those ten are: Argus Media, Inc., Bloomberg L.P., Btu/Data Transmission Network, Dow Jones and Company, Energy Intelligence Group, Intelligence Press, Inc. (NGI), IntercontinentalExchange, Inc. (IEX), Io Energy LLC, Platts, and Powerdex, Inc.<sup>127</sup>

120. *Id.* at 220.

121. See *Price Discovery in Natural Gas and Electric Markets, Policy Statement on Natural Gas and Electric Price Indices*, 104 F.E.R.C. ¶ 61,121 (2003).

122. FED. ENERGY REGULATORY COMM’N, REPORT ON NATURAL GAS AND ELECTRICITY PRICE INDICES, Docket Nos. PL03-3-004, AD03-7-004 (2004), available at <http://www.ferc.gov/EventCalendar/Files/20040505135203-Report-Price-Indices.pdf>.

123. *Price Discovery in Natural Gas and Electric Markets, Order Regarding Future Monitoring of Voluntary Price Formation, Use of Price Indices in Jurisdictional Tariffs, and Closing Certain Tariff Dockets*, 109 F.E.R.C. ¶ 61,184, 61,886 (2004).

124. *Id.* at 61,887.

125. 109 F.E.R.C. ¶ 61,184.

126. *Id.* at 61,889.

127. 109 F.E.R.C. ¶ 61,184, at 61,889.

This finding was significant because the final section of the order addresses “whether a particular index and price location may be used in jurisdictional tariffs.”<sup>128</sup> The indices published by the ten entities listed above are permitted to be used as price references in FERC jurisdictional tariffs.

The Commission carefully noted the importance of recognizing the difference between using a price index in jurisdictional tariffs from using one in commercial transactions. As the Commission stated, “price indices are widely used in market-based, commercial settings where parties are negotiating at arm’s-length and where the transactions either are non-jurisdictional or are entered into under blanket certificate or market-based rate authorities.”<sup>129</sup> These commercial “situations differ from tariff use of indices, as the participants can make their own informed choices about the indices on which they choose to rely in commercial transactions.”<sup>130</sup> The Commission thus explicitly limits its discussion to “the use of price indices in jurisdictional tariffs only, and does not affect market participants’ uses of price indices in commercial settings.”<sup>131</sup>

Accordingly, the Commission adopted criteria for minimum levels of activity at a particular trading location in order for that location to be referenced in jurisdictional tariffs for purposes such as: “(1) establishing cashout values, through mechanisms established in tariff provisions, for the resolution of volume imbalances between transporters and shippers and as components of operational balancing agreements on regulated pipelines and (2) determining certain penalties if a shipper fails to deliver nominated and scheduled gas supplies.”<sup>132</sup>

The Commission thus set the following minimum average standards:

Daily or hourly indices should meet at least one of the following conditions on average for all non-holiday weekdays within a 90 day review period:

1. Average daily volume traded of at least 25,000 MMBtus for gas or 2,000 MWh for power.
2. Average daily number of transactions of five or more.
3. Average daily number of counterparties of five or more.

Weekly indices should meet at least one of the following conditions on average for all weeks within a 90 day review period:

1. Average daily volume traded of at least 25,000 MMBtus/day for gas or 2,000 MWh/day for power.
2. Average daily number of transactions of eight or more per week.
3. Average daily number of counterparties of eight or more per week.

Monthly indices should meet at least one of the following conditions on average in a six month review period:

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128. *Id.*

129. *Price Discovery in Natural Gas and Electric Markets, Order Regarding Future Monitoring of Voluntary Price Formation, Use of Price Indices in Jurisdictional Tariffs, and Closing Certain Tariff Dockets*, 109 F.E.R.C. ¶ 61,184, 61,892 (2004).

130. *Id.*

131. 109 F.E.R.C. ¶ 61,184, at 61,892.

132. *Id.* at 61,894.

1. Average daily volume traded of 25,000 MMBtus/day for gas or 2,000 MWh/day for power.
2. Average daily number of transactions of ten or more per month.
3. Average daily number of counterparties of ten or more per month.<sup>133</sup>

The Commission determined that the policy for use of price indices in jurisdictional tariffs will be applied prospectively and “to any tariff filings which propose a new or changed index price location.”<sup>134</sup> Accordingly, when pipelines and utilities make such tariff filings they must “make a showing that each selected tariff location (1) is provided by an index developer that we have found meets or substantially meets the Policy Statement standards and (2) meets or exceeds one or more of the minimum average criteria for liquidity.”<sup>135</sup> Finally, the Commission closed ““13 dockets with respect to the issue of whether the price index locations filed in tariff sheets pass muster under the Policy Statement.”<sup>136</sup>

#### X. FERC AGREEMENTS REGARDING COOPERATION ON REVIEW OF PIPELINE/LNG PROJECTS

##### *A. The FERC, the Coast Guard, and the DOT Sign Interagency Agreement to Coordinate Review of LNG Terminal Safety*

On February 11, 2004, the FERC, the United States Coast Guard (USCG), and the Research and Special Programs Administration (RSPA) within the Department of Transportation (DOT) “announced an interagency agreement to provide for the comprehensive and coordinated review of land and marine safety and security issues at the nation’s liquefied natural gas (LNG) import terminals.”<sup>137</sup>

The purpose of the agreement is to ensure that the agencies “work in a coordinated manner to address issues regarding safety and security at waterfront LNG facilities, including the terminal facilities and tanker operations, to avoid duplication of effort, and to maximize the exchange of relevant information related to the safety and security aspects of LNG facilities and related marine concerns.”<sup>138</sup>

The agreement clearly delineates the roles and responsibilities of each

133. 109 F.E.R.C. ¶ 61,184, at 61,895–96.

134. *Price Discovery in Natural Gas and Electric Markets, Order Regarding Future Monitoring of Voluntary Price Formation, Use of Price Indices in Jurisdictional Tariffs, and Closing Certain Tariff Dockets*, 109 F.E.R.C. ¶ 61,184, 61,897 (2004).

135. *Id.*

136. 109 F.E.R.C. ¶ 61,184, at 61,897.

137. Press Release, Federal Energy Regulatory Commission, Commission, Coast Guard, DOT Sign Interagency Agreement to Coordinate Review of LNG Terminal Safety, Security (Feb. 11, 2004), available at <http://www.ferc.gov/press-room/pr-archives/2004/2004-1/02-11-04-interagency.asp>.

138. FED. ENERGY REGULATORY COMM’N ET AL., INTERAGENCY AGREEMENT AMONG THE FEDERAL ENERGY REGULATORY COMMISSION, UNITED STATES COAST GUARD AND RESEARCH AND SPECIAL PROGRAMS ADMINISTRATION FOR THE SAFETY AND SECURITY REVIEW OF WATERFRONT IMPORT/EXPORT LIQUEFIED NATURAL GAS FACILITIES 1 (2004), available at <http://www.ferc.gov/industries/gas/indus-act/LNG-Safety-Agreement.pdf> [hereinafter INTERAGENCY AGREEMENT].

agency relative to LNG terminals and LNG tanker operations, and stipulates that the agencies identify issues early and resolve them quickly.<sup>139</sup>

“[The] RSPA has authority to promulgate and enforce safety regulations and standards for the transportation and storage of LNG in or affecting interstate or foreign commerce under the pipeline safety laws (49 U.S.C. Chapter 601). RSPA’s authority extends to the siting, design, installation, construction, initial inspection, initial testing, operation, maintenance of LNG facilities.

The USCG exercises regulatory authority over LNG facilities which affect the safety and security of port areas and navigable waterways under E.O. 10173, the Magnuson Act . . . the Ports and Waterways Safety Act . . . , and the Maritime Transportation Security Act . . . The USCG has authority for LNG facility security plan review, approval and compliance verification as provided in Title 33 CFR Part 105, and siting as it pertains to the management of vessel traffic in and around the LNG facility.<sup>140</sup>

The FERC will be the lead agency for environmental review under the National Environmental Policy Act (NEPA).<sup>141</sup> The FERC will coordinate its review with the RSPA and the USCG to ensure “that the NEPA document conveys complete information to the involved stakeholders. . . . The FERC NEPA document is also intended to meet the needs of the [RSPA and the USCG so] that any necessary permits can be issued concurrently with the FERC authorizations.”<sup>142</sup>

#### *B. The FERC and Mexico Sign Agreement on Energy Project Cooperation*

On November 5, 2004, the FERC and Mexico’s Comisión Reguladora de Energía (CRE) “signed a Letter of Intent to enhance interagency coordination on cross-border energy projects.”<sup>143</sup> Mexico’s CRE regulates natural gas and electricity imports, sales, transmission, and distribution.

“The agreement addresses the sharing of information between FERC and the CRE, and calls for the two agencies to coordinate the timing of regulatory decisions to the extent possible.<sup>144</sup> Specifically, the agreement states that “[w]hen either Party becomes aware that a proceeding before it involves matters that may also be pending before the other party, it will promptly notify the other party accordingly.”<sup>145</sup> Additionally, the agreement holds open the potential of coordinated reviews when “related matters are pending before each agency.”<sup>146</sup>

#### *C. The FERC and Canada Sign Agreement on Energy Project Cooperation*

On May 10, 2004, the FERC and Canada’s National Energy Board (NEB) “signed a Memorandum of Understanding (MOU) to enhance interagency coordination on cross-border natural gas pipelines. FERC Chairman Pat Wood, III and NEB Chairman Ken Vollman signed the MOU in Halifax, Nova Scotia,

139. *Id.*

140. INTERAGENCY AGREEMENT, *supra* note 139, at 2.

141. *Id.*

142. INTERAGENCY AGREEMENT, *supra* note 139, at 2.

143. Press Release, Federal Energy Regulatory Commission, Mexico’s Federal Energy Commission Sign Agreement on Energy Project Cooperation 30 (Nov. 5, 2004), available at [www.ferc.gov/press-room/pr-current/11-05-04.pdf](http://www.ferc.gov/press-room/pr-current/11-05-04.pdf).

144. *Id.*

145. Press Release, Federal Energy Regulatory Commission, Mexico’s Federal Energy Commission Sign Agreement on Energy Project Cooperation 32 (Nov. 5, 2004).

146. *Id.*

where they were attending the annual conference of the Canadian Association of Members of Public Utility Tribunals.”<sup>147</sup>

The NEB “is an independent federal agency that regulates several aspects of Canada’s energy industry. Its purpose is to promote safety, environmental protection and economic efficiency in the Canadian public interest within the mandate set by Parliament in the regulation of pipelines, energy development and trade.”<sup>148</sup>

“The MOU addresses the sharing of information between FERC and the NEB, and calls for the two agencies to coordinate the timing of pipeline regulatory decisions to the extent possible.”<sup>149</sup> The MOU further contemplates the possibility of coordinated reviews when “related matters are pending before both agencies.”<sup>150</sup> The MOU adds that “the two agencies will, where practicable, coordinate the timing of related decision making, including but not limited to coordinating the submission of evidence, the timing of developing findings of facts and conclusions of law, and the ultimate resolution of the related matters.”<sup>151</sup> Chairman Wood stated, “Sharing of information and timely decision-making are two critical elements for the siting and construction of a natural gas pipeline across Canada to bring natural gas stranded in Alaska to the lower 48 states.”<sup>152</sup>

#### XI. PROPOSED RULE GOVERNING OPEN SEASONS FOR POTENTIAL ALASKA NATURAL GAS TRANSPORTATION PROJECTS.

On November 15, 2004, the Commission issued a NOPR in “Regulations Governing the Conduct of Open Seasons for Alaska Natural Gas Transportation Projects.”<sup>153</sup> The NOPR sought comments on proposed rules for the conduct of open seasons for potential Alaska Natural Gas transportation projects. The deadline for the submission of comments was December 17, 2004.

The NOPR was required by the Alaska Natural Gas Pipeline Act (ANGP Act),<sup>154</sup> which became law on October 13, 2004. The law requires the FERC to expeditiously process any application for an Alaska natural gas transportation project, as defined in the ANGP Act. The NOPR primarily concerns one aspect of the ANGP Act, namely the part directing “the Commission to prescribe the rules which will apply to any open season held for the purpose of soliciting

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147. Press Release, Federal Energy Regulatory Commission, National Energy Board of Canada Sign Agreement on Natural Gas Pipeline Cooperation 30 (May 10, 2004), available at [www.ferc.gov/press-room/pr-archives/2004/2004-2/05-10-04.pdf](http://www.ferc.gov/press-room/pr-archives/2004/2004-2/05-10-04.pdf).

148. *Id.*

149. Press Release, Federal Energy Regulatory Commission, National Energy Board of Canada Sign Agreement on Natural Gas Pipeline Cooperation 30 (May 10, 2004).

150. NAT’L ENERGY BD. & FED. ENERGY REGULATORY COMM’N, MEMORANDUM OF UNDERSTANDING BETWEEN NATIONAL ENERGY BOARD AND FEDERAL ENERGY REGULATORY COMMISSION (2004), available at [www.ferc.gov/industries/gas/gen-info/mou.pdf](http://www.ferc.gov/industries/gas/gen-info/mou.pdf).

151. *Id.*

152. Press Release, Federal Energy Regulatory Commission, National Energy Board of Canada Sign Agreement on Natural Gas Pipeline Cooperation 30 (May 10, 2004) (quoting FERC Chairman Pat Wood, III).

153. Notice of Proposed Rulemaking, *Regulations Governing the Conduct of Open Seasons for Alaska Natural Gas Transportation Projects*, F.E.R.C. STATS. & REGS. ¶ 32,577, 69 Fed. Reg. 68,106 (2004) [hereinafter *Open Seasons Regulations*].

154. H.R. 4837, 108th Cong. (2004) (enacted).

interest in, or making binding commitments to the acquisition of capacity on, any Alaska natural gas transportation project, including the criteria for allocating capacity among competing bidders.”<sup>155</sup> The statute gave the FERC 120 days from the date of enactment to issue a final rule regarding open season requirements, or until February 10, 2005. The Final Rule is still pending.

The proposed rule would apply to any applications for certificates pursuant to the Natural Gas Act,<sup>156</sup> the Alaska Natural Gas Transportation Act of 1976,<sup>157</sup> or the ANGP Act.<sup>158</sup> Proposed Section 157.33 requires that applicants for an Alaskan project make a showing that they have held an open season.<sup>159</sup> Proposed Section 157.34 sets forth the open season procedures. These procedures include the requirement that the public be given prior notification of the open season at least thirty days before it commences and that the open season remain open for ninety days.<sup>160</sup> Section 157.34(b) is a comprehensive list of the information that must be included in the open season “to the extent that such information is known or determined at the time the notice is issued.”<sup>161</sup> The list includes: (1) the pipeline route; (2) receipt and delivery points; (3) size and design capacity; (4) pressure information; (5) projected in-service date; (6) estimated rates; (7) fuel retention percentages and other applicable charges; (8) the estimated costs of proposed facilities and cost of service and expected return on equity; (9) negotiated rate information; (10) quality specifications; (11) the terms and conditions for each service offered; (12) creditworthiness standards; (13) the deadline, if any, for the execution of precedent agreements; (14) bid evaluation criteria; (15) bidding requirements; and (16) the projected certificate application filing date with the Commission.<sup>162</sup> This level of detail is required, the Commission said, “to create an open season process that provides non-discriminatory access to capacity on any Alaska natural gas transportation project while, at the same time, ensuring sufficient economic certainty to support the construction of the pipeline and thereby provide a stimulus for exploration, development and production of Alaska natural gas.”<sup>163</sup> The Commission acknowledged, however, that a project sponsor may wish to hold two open seasons, a non-binding open season to obtain information and a binding open season which would incorporate the information developed in the first round.<sup>164</sup> Section 157.35 requires that any capacity allocated as a result of the open season be “without undue discrimination or preference of any kind.”<sup>165</sup> Additionally, Section 157.36 provides that “[a]ny open season for capacity exceeding the initial capacity of an Alaska natural gas transportation project must provide the opportunity for the transportation of gas other than Prudhoe Bay or Point

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155. *Open Seasons Regulations*, *supra* note 154, at 32,086.

156. 15 U.S.C. §§ 717–717w (2000).

157. 15 U.S.C. §§ 719–719o (2000).

158. 15 U.S.C. §§ 720–720n (2000).

159. *Open Seasons Regulations*, *supra* note 154.

160. *Id.*

161. *Open Seasons Regulations*, *supra* note 154, at 32,092.

162. *Id.* at 32,092–93.

163. *Open Seasons Regulations*, *supra* note 154, at 32,088.

164. *Id.* at 32,093.

165. *Open Seasons Regulations*, *supra* note 154, at 32,093.



Thomson production.”<sup>166</sup>

In its current proposal, the open season regulations would not apply to Commission-ordered expansions under section 105 of the ANGP Act. However, the Commission has left open the possibility that its open season regulations may, in the future, be applied to expansions that it orders under section 105.<sup>167</sup>

In addition to the proposed rules, the NOPR asked the public to address a series of related questions: (1) whether the Commission should review the open season proposals before they become effective and how to respond to any objections to an open season; (2) whether to issue rules now pursuant to section 105 of the ANGP Act relating to pipeline expansions, particularly the question of rolled-in or incremental pricing of any such expansion; (3) whether the Commission should allow parties to reserve or pre-subscribe capacity on the project; (4) whether the ANGP Act’s requirement to promote competition in the exploration, development, and production of Alaska natural gas conflicts with existing Commission open season policies; and (5) whether project capacity might be tied to the receipt of ancillary services involving gas treatment or capacity at a gas treatment plant or other facility.<sup>168</sup> To assist the Commission in responding to the ANGP Act’s requirements, the Commission held a technical conference in Alaska on December 3, 2004.

#### *A. Alaska Natural Gas Pipeline Act*

On October 13, 2004, the President signed legislation that included the ANGP Act.<sup>169</sup> Section 103(e) of the ANGP Act requires the FERC to promulgate regulations governing an open season for the Alaskan gas transportation project within 120 days of enactment. Furthermore, the section requires that, with limited exception, all initial and expansion capacity in the project be allocated by the open season procedures. The Commission’s regulations must provide for the open season criteria and timing and promote exploration and development competition in Alaska. Open seasons for other than the initial capacity must provide for the opportunity to transport gas from locations other than Prudhoe Bay and Point Thomson.

The ANGP Act includes these other important provisions:

Section 103 allows the FERC to consider and act upon an application for a certificate for an Alaskan natural gas pipeline project other than the one that the President has already approved under the Alaska Natural Gas Transportation Act of 1976.<sup>170</sup>

Section 103(c) requires expedited action by the FERC in issuing the certificate of public convenience and necessity. This expedition requirement complements the requirement of Section 104(d) that the Commission issue the environmental impact statement on an expedited basis.

Section 103(g) requires the certificate applicant to study the in-state needs for Alaskan gas.

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166. *Id.*

167. *Open Seasons Regulations*, *supra* note 154, at 32,088.

168. *Id.* at 32,089.

169. Alaska Natural Gas Pipeline Act, Pub. L. No. 108-324, 118 Stat. 1220 (2004).

170. 15 U.S.C. §§ 719–20 (Supp. 2004).

Section 103(h) provides the state with reasonable pipeline access so that it may transport its royalty gas.

Section 104 makes the FERC the lead agency for federal environmental review purposes.

Section 105 gives the FERC the authority to order expansion of the project under certain circumstances. The section provides, among other conditions, that the FERC must “approve or establish rates for the expansion service that are designed to ensure the recovery, on an incremental or rolled-in basis, of the cost associated with the expansion (including a reasonable rate of return on investment)” and “ensure that the rates do not require existing shippers on the Alaska natural gas transportation project to subsidize expansion shippers . . . .”<sup>171</sup>

Section 106 establishes a special office of the Federal Coordinator.

Section 107 provides for the United States Court of Appeals for the District of Columbia Circuit to have original and exclusive jurisdiction to review federal agency decisions. The court is to act expeditiously in processing any appeals.

Section 109 requires that if no party files an application for a certificate for the project within eighteen months, the Secretary of Energy must conduct a study of alternative approaches to the construction and operation of the project, including the possibility that a federal government corporation should be established to construct it.

The Act clarifies that the FERC under certain conditions can amend existing certificates or authorizations granted under the Alaska Natural Gas Transportation Act of 1976.

Congress provided financial underpinning for the Alaskan natural gas pipeline project in section 116. It provides that the Secretary of Energy may “issue a Federal guarantee instrument” with certificate holders, including the holders of rights to build the Canadian portion of the project.<sup>172</sup> These guarantees are limited to 80% of project cost, up to \$18 billion (in current dollars).

## XII. NOTICE OF INQUIRY ISSUED RE: PIPELINE DISCOUNTING PRACTICES TO MEET GAS-ON-GAS COMPETITION

The FERC issued a notice of inquiry (NOI) to review its policy of selective discounting for interstate natural gas pipelines.<sup>173</sup> The central issue for comment was whether discounts provided by pipelines to their customers to meet competition from other sources of natural gas, referred to as discounts to meet “gas-on-gas” competition, remain just and reasonable. The Commission was not looking to eliminate the pipeline’s flexibility to offer such discounts. Instead, it focused on the reasonableness of the Commission’s practice of permitting pipelines to adjust their ratemaking throughput downward in rate cases to reflect discounts to meet gas-on-gas competition.

The Commission has allowed selective discounting on a non-discriminatory

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171. 15 U.S.C. § 720(c) (Supp. 2004).

172. 15 U.S.C. § 720(n) (Supp. 2004).

173. Notice of Inquiry, *Policy for Selective Discounting By Natural Gas Pipelines*, 69 Fed. Reg. 70,077 (2004).

basis since it adopted open access transportation under Order No. 436.<sup>174</sup> The Commission at that time provided for the establishment of minimum and maximum rates, with the minimum rates designed to collect the variable costs of providing service. The theory supporting this policy was that all customers are better off if a pipeline can reduce rates to meet competition and spread fixed costs over a larger customer base, provided that the pipeline collects at least some fixed costs from the discounted customers. The United States Court of Appeals for the District of Columbia Circuit affirmed this policy.<sup>175</sup> Language in the court's order supported the pipelines' claim for a rate adjustment to make up for revenues lost from discounting.<sup>176</sup> The Commission later codified this policy in its "Rate Design Policy Statement."<sup>177</sup>

The NOI arises primarily out of two actions by the Illinois Municipal Gas Agency (IMGA). First, in Docket No. RM97-7-000, the IMGA petitioned the FERC to issue a rule that would not allow adjustments for discounts given by a pipeline to meet gas-on-gas competition with other jurisdictional pipelines. The IMGA argued that the Commission's policy of allowing discount adjustments for transactions involving gas-on-gas competition raises rates to captive customers. The IMGA has claimed that over 75% of discounts provided by pipelines are in response to gas-on-gas competition.<sup>178</sup> Second, the IMGA petitioned the court of appeals for review of Order No. 637<sup>179</sup> raising the same issue. The court denied the IMGA's petition but warned the FERC that it could not delay resolution of the issue indefinitely.<sup>180</sup>

In addition to comments on the issue raised by the IMGA, the NOI sought comments on such issues as the effect of elimination of the periodic rate case filing requirement on discounting practices and the effect that the standards of conduct may have on affiliate discount behavior. Commissioner Brownell

174. See Order No. 436, *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, [Regs. Preambles 1982–1985] F.E.R.C. STATS. & REGS. ¶ 30,665, 31,543–45, 50 Fed. Reg. 42,408 (1985) (to be codified at 18 C.F.R. pts. 2, 157, 250, 284, 375, 381) [hereinafter Order No. 436], *reh'g granted in part and denied in part*, Order No. 436-A, *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, [Regs. Preambles 1982–1985] F.E.R.C. STATS. & REGS. ¶ 30,675, 50 Fed. Reg. 52,217 (1985) (to be codified at 18 C.F.R. pts. 2, 157, 284, 375), *reh'g granted in part*, Order No. 436-B, *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, [Regs. Preambles 1986–1990] F.E.R.C. STATS. & REGS. ¶ 30,688, 51 Fed. Reg. 6398 (1986) (to be codified at 18 C.F.R. pt. 284), *vacated and remanded sub nom.* *Associated Gas Distrib. v. FERC*, 824 F.2d 981 (D.C. Cir. 1987).

175. *Associated Gas Distrib.*, 824 F.2d at 1010–12.

176. *Id.* at 1012.

177. *Interstate Natural Gas Pipeline Rate Design*, 47 F.E.R.C. ¶ 61,295 (1989), *order on reh'g*, 48 F.E.R.C. ¶ 61,122 (1989).

178. Notice of Inquiry, *Policy for Selective Discounting By Natural Gas Pipelines*, 69 Fed. Reg. 70,077, 70,079 (2004).

179. Order No. 637, *Regulation of Short-Term Natural Gas Transportation Services, and Regulation of Interstate Natural Gas Transportation Services*, [Regs. Preambles 1996–2000] F.E.R.C. STATS. & REGS. ¶ 31,091, 65 Fed. Reg. 10,156 (2000) (to be codified at 18 C.F.R. pts. 154, 161, 250, 284), *order on reh'g*, Order No. 637-A, *Regulation of Short-Term Natural Gas Transportation Services, and Regulation of Interstate Natural Gas Transportation Services*, [Regs. Preambles 1996–2000] F.E.R.C. STATS. & REGS. ¶ 31,099, 65 Fed. Reg. 35,705 (2000) (to be codified at 18 C.F.R. pts. 154, 161, 250, 284), *reh'g denied*, Order No. 637-B, 92 F.E.R.C. ¶ 61,062 (2000), *aff'd in part and remanded in part sub nom.* *Interstate Natural Gas Assoc. of Am. v. FERC*, 285 F.3d 18 (D.C. Cir. 2002); *order on remand*, 101 F.E.R.C. ¶ 61,127 (2002); *order on reh'g and clarification*, 106 F.E.R.C. ¶ 61,088 (2004).

180. *INGAA v. FERC*, 285 F.3d 18, 57–58 (D.C. Cir. 2002).

concluded in the NOI, expressing the view that the inquiry should have been limited to the issue of discounts to meet gas-on-gas competition as raised by IMGA. Comments were due to be filed in late January 2005.

### XIII. THE FERC CLARIFIES MODIFIED NEGOTIATED RATE POLICY

In 2004, the FERC issued several orders applying its Modified Negotiated Rate Policy, which sets out precise requirements for natural gas companies seeking approval of negotiated rate agreements.<sup>181</sup>

The Commission's regulations require that pipelines include in their tariff a form of service agreement, and file any contract that deviates materially from the form of service agreement.<sup>182</sup> The Commission has held that a material deviation includes "any provision of a service agreement [that is not in the approved language of the form of service agreement] and goes beyond filling-in of the spaces . . . with the appropriate information provided for in the tariff affects the substantive rights of the parties."<sup>183</sup> In recent cases, the Commission has determined that the following negotiated terms, among others, would be considered material changes to the form of service agreement: assignment clause,<sup>184</sup> predetermination (termination) clause,<sup>185</sup> "regulatory matters and the rights of parties to renegotiate the service if the Commission modifies the agreement,"<sup>186</sup> choice of law,<sup>187</sup> provider of last resort rights,<sup>188</sup> and pressure and hourly flow obligations.<sup>189</sup>

The filing of non-conforming agreements enables the Commission and other interested parties to ascertain whether the material deviations comply with the requirements of the Natural Gas Act, including a determination that the pipelines have not engaged in undue discrimination. In outlining its Modified Negotiated Rate Policy, the Commission noted that where pipelines had filed negotiated rate service agreements with material deviations, the deviations often had not been clearly identified.<sup>190</sup> This required "the Commission to carefully compare the negotiated rate agreement with the form of service agreement in order to determine how the two may differ."<sup>191</sup>

To ease the Commission's assessment of non-conforming agreements, the Modified Negotiated Rates Policy:

require[s] that a pipeline filing a [negotiated rate] contract proposing material changes from its form of service agreement . . . clearly delineate differences between its negotiated contractual terms and that of its form of service agreement in redline and strikeout. In addition, the pipeline shall provide a detailed narrative

181. See *Natural Gas Pipeline Negotiated Rate Policies and Practices*, 104 F.E.R.C. ¶ 61,134 (2003).

182. 18 C.F.R. §§ 154.1(d), 154.110 (2003).

183. 104 F.E.R.C. ¶ 61,134, at 61,486 (citing *Columbia Gas Transmission Corp.*, 97 F.E.R.C. ¶ 61,221, 62,002 (2001)).

184. *E. Tenn. Natural Gas Co.*, 107 F.E.R.C. ¶ 61,197, 61,892 (2004).

185. *Id.* at 61,893.

186. 107 F.E.R.C. ¶ 61,197, at 61,893.

187. *Id.*

188. *ANR Pipeline Co.*, 107 F.E.R.C. ¶ 61,094 at 61,298 (2004).

189. 97 F.E.R.C. ¶ 61,221, at 62,002-03.

190. *Natural Gas Pipeline Negotiated Rate Policies and Practices*, 104 F.E.R.C. ¶ 61,134, 61,487 (2003).

191. *Id.*

outlining the terms of its negotiated contract, the manner in which such terms differ from its form of service agreement, the effect of such terms on the rights of the parties, and why such deviation does not present a risk of undue discrimination.<sup>192</sup>

Thus, the Commission now demands that the form of service agreement be the starting point to the crafting of a negotiated rate agreement.<sup>193</sup> For example, if a natural gas company “includes specific operating conditions in individual contracts, [but the conditions are not included in its form of service agreement, the company] must file [the individual] contracts as non-conforming contracts and explain why the provisions should not be included in its tariff and be made available to all shippers.”<sup>194</sup> The Commission also has stipulated that “[p]lacing [any] modification in a separate letter agreement that is intended to control the negotiated service agreement is not a permissible manner in which to comply with the Commission’s filing requirements for negotiated transactions.”<sup>195</sup> If the negotiated service agreement is properly filed, it will control the non-rate rights and obligations of the parties to the negotiated service agreement.<sup>196</sup>

*A. Index-Based Pricing Under Negotiated and Discounted Rate Transactions.*

In *ANR Pipeline Co.*,<sup>197</sup> the Commission, among other things,<sup>198</sup> approved a tariff revision proposed by ANR Pipeline Company (ANR) providing it with the option to discount rates based on published gas price indices. The Commission held that the proposed tariff language generally is consistent with its new policy, articulated in response to the court’s remand in *Northern Natural Gas Co. v. FERC*,<sup>199</sup> permitting “discounts based on price indices,” as long as the “discounted rates . . . fall within the range established by the pipeline’s maximum and minimum rates.”<sup>200</sup> The Commission’s acceptance of the proposed tariff revision was conditioned upon ANR revising the language to clarify “that at no time [during the period of the service agreement] will the shipper be required to pay more than the maximum rate or be permitted to pay less than the minimum rate.”<sup>201</sup>

In *ANR Pipeline Co.*,<sup>202</sup> the Commission (Chairman Wood dissenting) approved ANR’s use of a negotiated rate including a fixed annual demand fee to be paid by the shippers allowing ANR to recover variable costs it would

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192. 104 F.E.R.C. ¶ 61,134, at 61,487.

193. *E. Tenn. Natural Gas Co.*, 107 F.E.R.C. ¶ 61,197 (2004).

194. *El Paso Natural Gas Co.*, 109 F.E.R.C. ¶ 61,146, 61,568 (2004).

195. 107 F.E.R.C. ¶ 61,197, at 61,892.

196. *Id.*

197. *ANR Pipeline Co.*, 108 F.E.R.C. ¶ 61,028 (2004).

198. The order also rejected, without prejudice to the proposals being filed as new rate schedules, ANR’s proposed tariff options (1) allowing discounting based on the negotiation of a “must flow” provision within the service contract, and (2) offering a “linked contract” under which ANR could satisfy requests for service made by shippers that ANR would otherwise have to deny due to prevailing operating conditions. *Id.* at 61,173–76.

199. *N. Natural Gas Co. v. FERC*, 335 F.3d 1089 (D.C. Cir. 2003).

200. 108 F.E.R.C. ¶ 61,028, at 61,175 (citing *N. Natural Gas Co.*, 105 F.E.R.C. ¶ 61,299 (2003); 18 C.F.R. § 284.10(c)(5) (2003)).

201. *Id.*

202. *ANR Pipeline Co.*, 107 F.E.R.C. ¶ 61,013 (2004). The Commission subsequently approved an almost identical negotiated rate agreement involving a different shipper, with Chairman Wood once again dissenting. *ANR Pipeline Co.*, 107 F.E.R.C. ¶ 61,241 (2004).

otherwise obtain in its usage charges. The negotiated rate agreement also permits ANR to share in the shipper's "revenue from its physical sale of gas plus any NYMEX or seasonal storage spreads earned by [the shipper] associated with [its] use of the agreement."<sup>203</sup> Under the agreement, the shipper is required to "maintain a 'Shared Account' into which it will record the subject revenue. For each annual period, the positive amounts in the Shared Account will be shared between ANR and [the shipper] according to [a] schedule" under which the percentage of revenues shared by ANR is determined pursuant to three revenue ranges.<sup>204</sup>

The Commission held that ANR's negotiated rate proposal was acceptable in light of the Commission determination on remand in *Northern Natural*<sup>205</sup> that the use of basis differentials in discounted rate transactions is permissible. The Commission explained that the concerns associated with "basis differentials in negotiated rates [are] not [at issue] to the same degree in the context of discounted rates" because, unlike negotiated rates, the discounted rates "are capped by the pipeline's maximum cost-of-service rate."<sup>206</sup> The Commission observed that concerns that basis differential pricing will give the pipeline an incentive to withhold capacity in order to obtain higher revenues than otherwise would be possible under its maximum cost-of-service rates do not exist to the same degree in the discounted rate context.<sup>207</sup> In addition, the Commission held that the negotiated rate agreement was consistent with its policy due to the fact that ANR agreed to cap the annual revenue it could earn "at the amount it would have earned on an annual basis if it had charged the maximum tariff rate for the services involved."<sup>208</sup>

In his dissent, Chairman Wood advocated the rejection of ANR's negotiated rate agreement "because it gives the pipeline a direct interest in natural gas commodity prices."<sup>209</sup> The Chairman maintained that any negotiated rate agreement giving a pipeline an interest in commodity prices provides an incentive for market manipulation. Unlike the case in *Northern Natural*,<sup>210</sup> the Chairman argued "that the benefits of allowing basis differentials to value the transportation service outweighed the potential harm of giving the pipeline an incentive to withhold capacity."<sup>211</sup>

#### *B. The FERC Rejects Discount Letter Agreements Containing NGA Section 5 Waiver Provisions*

The Commission issued an order on November 5, 2004,<sup>212</sup> holding that

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203. *ANR Pipeline Co.*, 108 F.E.R.C. ¶ 61,028, 61,035 (2004).

204. *Id.*

205. *N. Natural Gas Co.*, 105 F.E.R.C. ¶ 61,299 (2003).

206. 107 F.E.R.C. ¶ 61,013, at 61,036.

207. 108 F.E.R.C. ¶ 61,028, at 61,036.

208. *Id.*

209. 108 F.E.R.C. ¶ 61,028, at 61,036.

210. *N. Natural Gas Co.*, 105 F.E.R.C. ¶ 61,299 (2003).

211. 108 F.E.R.C. ¶ 61,028, at 61,037.

212. *Columbia Gulf Transmission Co.*, 109 F.E.R.C. ¶ 61,152 (2004).

certain Natural Gas Act (NGA) section 5<sup>213</sup> waiver provisions set forth in discount letter agreements filed by Columbia Gas Transmission Corporation (Columbia) and Columbia Gulf Transmission Company (Columbia Gulf) on October 8, 2004, were overly broad in scope, contrary to Commission policy, and to the extent appropriately narrowed, could only be filed in the context of a negotiated rate agreement.<sup>214</sup> The Commission determined that pipelines are prohibited from including provisions in discounted rate agreements that limit the rights of shippers to pursue section 5 actions to modify the pipeline's recourse rates.<sup>215</sup> Along with precluding the use of section 5 waiver provisions in discount letter agreements, the Commission held that the subject provisions were broader than those approved in previous cases involving negotiated rate transactions, as the shippers would waive their right to challenge all of the pipelines' base rates and the entire rate structure.<sup>216</sup>

The Commission explained that appropriate scope of a Section 5 waiver provision in the context of a negotiated rate agreement is limited to challenges to the specific rates charged under the subject service agreements.<sup>217</sup> The Commission emphasized that its concern with section 5 waiver provisions is heightened in the context of discounted rate agreements because, unlike the case with negotiated rate transactions, the shippers do not have the alternative "of obtaining service at the just and reasonable recourse rate."<sup>218</sup> In addition, the Commission held that the United States Court of Appeals for the District of Columbia's decision in *Northern Natural Gas Co. v. FERC*, which concerned the distinction between discounted rates and negotiated rates, is not relevant because the issue here is not the nature of the rate, but rather the conditions imposed by the pipelines on the shippers' NGA section 5 rights.<sup>219</sup>

Based on these findings, the Commission directed Columbia and Columbia Gulf to either file a statement that the NGA section 5 waiver provisions have been removed or refile the agreements as negotiated rate agreements containing clauses that are properly limited in scope, consistent with the order.<sup>220</sup>

#### XIV. AWARD OF AVAILABLE CAPACITY TO SHORT-HAUL BIDS

On April 15, 2004, the Commission sought industry comments on its policy regarding the award of available capacity to short-haul bids.<sup>221</sup> The inquiry stemmed from a pipeline filing proposing that shippers bidding on less than the full length of haul of available capacity (short haul) could not acquire the capacity for more than thirty-one days.<sup>222</sup> The Commission had rejected the filing, citing to the policy adopted in Order No. 636<sup>223</sup> that required pipelines to

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213. 15 U.S.C. § 717d (2000).

214. 109 F.E.R.C. ¶ 61,152, at 61,614.

215. *Id.*

216. 109 F.E.R.C. ¶ 61,152, at 61,614.

217. *Id.* at 61,615.

218. *Columbia Gulf Transmission Co.*, 109 F.E.R.C. ¶ 61,152, 61,614 (2004).

219. *Id.* at 61,615.

220. 109 F.E.R.C. ¶ 61,152, at 61,616.

221. *N. Border Pipeline Co.*, 107 F.E.R.C. ¶ 61,027 (2004).

222. *Id.* at 61,109.

223. Order No. 636, *Pipeline Service Obligations and Revisions to Regulations Governing Self-*

offer all of their existing capacity for sale to parties willing to pay the maximum rate.<sup>224</sup> The pipeline argued, on rehearing, that an exception to that policy should be made for bids on mileage-based pipeline systems, where shortening the path leads to reducing the maximum rate, preventing the pipeline from selling the entire path at a later time, increasing the likelihood that the pipeline would file a rate case, and that the policy prevents the pipeline from timing the sale of capacity in response to basis differential changes in commodity prices.

The Commission found that the case raised important issues regarding its policies on both awards of capacity and the right of first refusal (ROFR).<sup>225</sup> Although its current policy had sought to balance the interests of pipelines and shippers, the Commission noted the pipeline's argument that shippers' bids did not reflect the long-term value of the capacity. The Commission also noted that if shippers were awarded short-haul bids for one year or more, they would possess ongoing ROFR rights to renew their contracts and potentially strand capacity for significant periods of time. The Commission sought industry comment on a number of options, including: (1) retaining the current policy; (2) allowing pipeline discretion as to sell or not sell short-haul capacity at the maximum rate, similar to pipeline discretion as to discounted rates; (3) requiring pipelines to award the bid to the short-haul shipper, subject to periodic re-posting and re-bidding of the full length of the capacity; and (4) requiring the pipeline to allocate capacity to the winning short-haul bidder, but conditioning the shipper's ROFR rights on having to match bids for the full length of the haul. The Commission sought factual and policy input on several additional issues. Commissioner Brownell concurred and posed additional questions. The Commission subsequently received numerous comments from a range of parties in the industry.

#### XV. JURISDICTIONALITY OF LNG FACILITIES: *SOUND ENERGY SOLUTIONS V. FERC*

On March 24, 2004, responding to an assertion by the California Public Utilities Commission (CPUC) that it, not the FERC, has jurisdiction over the

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*Implementing Transportation; and Regulation of Natural Gas Pipelines after Wellhead Decontrol*, [Regs. Preambles 1991–1996] 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, *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation Under Part 284 of the Commission's Regulations, Regulation of Natural Gas After Wellhead Decontrol*, [Regs. Preambles 1991–1996] F.E.R.C. STATS. & REGS. ¶ 30,950, 57 Fed. Reg. 36,128 (1992) (to be codified at 18 C.F.R. pt. 284), *order on reh'g*, Order No. 636-B, *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation Under Part 284 of the Commission's Regulations*, 61 F.E.R.C. ¶ 61,272 (1992), *reh'g denied*, 62 F.E.R.C. ¶ 61,007 (1993), *aff'd in part and vacated and remanded in part, sub nom.* United Distribution Cos. v. FERC, 88 F.3d 1105 (D.C. Cir. 1996), *cert. denied* 520 U.S. 1224 (1997), *order on remand*, Order No. 636-C, *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation Under Part 284 of the Commission's Regulations*, 78 F.E.R.C. ¶ 61,186 (1997), *order on reh'g*, Order No. 636-D, *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation Under Part 284 of the Commission's Regulations*, 83 FERC ¶ 61,210 (1998), *aff'd in part and remanded in part sub nom.* Interstate Natural Gas Assoc. of Am. v. FERC, 285 F.3d 18 (D.C. Cir. 2002).

224. *N. Border Pipeline Co.*, 104 F.E.R.C. ¶ 61,264 (2003).

225. *Id.* at 61,854–55.



siting and operation of a liquefied natural gas import terminal that Sound Energy Solutions (SES) proposes to construct and operate at the Port of Long Beach, California, the FERC issued an order asserting exclusive jurisdiction over that facility pursuant to section 3 of the NGA.<sup>226</sup>

The issue arose after SES filed an application with the FERC under section 3 of the NGA for authorization to site, construct, and operate the terminal at the Port of Long Beach for purposes of importing LNG into the California market. The CPUC responded to SES's application by asserting that the FERC's jurisdiction over the project was limited to authorizing SES to import foreign LNG supplies, stating that nothing in NGA section 3 expressly addresses the siting, construction, or operation of LNG import facilities. The CPUC maintained that because the LNG to be imported via the terminal will be transported and consumed within the State of California, the proposed project involves only intrastate activity and does not implicate interstate commerce.<sup>227</sup> As a result, the CPUC stated that it would "assert jurisdiction to regulate the siting and safety of the proposed LNG facilities, to dictate curtailment priorities, and to protect against any exercise of market power by SES."<sup>228</sup>

Citing the U.S. Court of Appeals for the District of Columbia Circuit's 1974 decision in *Distrigas Corp. v. FPC (Distrigas)*, the FERC stated that it has long been recognized that, with respect to its import authority under section 3, it is authorized to "exercise[] with respect [to imports of LNG] the same detailed regulatory authority that it exercises with respect to interstate commerce in natural gas."<sup>229</sup> The Commission continued, noting the D.C. Circuit's holding that, so long as it exercises its authority responsibly, the FERC may "impose on imports of natural gas the equivalent of [NGA] Section 7 certification requirements both as to facilities and . . . as to sales within and without the state of importation."<sup>230</sup> The Commission noted that, since *Distrigas*, it has imposed the equivalent of section 7 certification requirements when exercising its section 3 authority over siting, construction, and operation of facilities used to import or export gas.

The Commission recounted that, in 2001, its routine exercise of its section 3 authority over natural gas and LNG import/export facilities was challenged, for the first time, in *Dynegy LNG Production Terminal L.P. (Dynegy)*,<sup>231</sup> on grounds similar to those advanced by the CPUC. In that proceeding, Dynegy argued that the Energy Policy Act of 1992 removed what authority the Commission had to condition section 3 import authority. In response to a similar argument by the CPUC in the instant docket, the FERC examined the language of the Energy Policy Act and its legislative history, concluding, as it did in *Dynegy*, that Congress was well aware of the conditioning authority the Commission consistently had exercised over import facilities under section 3 during the almost twenty years preceding the Energy Policy Act and that, nevertheless,

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226. *Sound Energy Solutions*, 106 F.E.R.C. ¶ 61,279 (2004).

227. *Id.* at 62,015.

228. 106 F.E.R.C. ¶ 61,279, at 62,015.

229. *Id.* at 62,016 (quoting *Distrigas Corp. v. FPC*, 495 F.2d 1057, 1064).

230. 106 F.E.R.C. ¶ 61,279, at 62,016 (alteration in original).

231. *Dynegy LNG Prod. Terminal*, 97 F.E.R.C. ¶ 61,231 (2001).

Congress failed to expressly condition or otherwise limit that authority in the 1992 Act.<sup>232</sup> The FERC stated, “[I]n view of this, we cannot accept the CPUC’s assertion that the Commission lacks sufficient authority to regulate SES’ proposed import facilities.”<sup>233</sup>

Returning to the D.C. Circuit’s decision in *Distrigas*, the Commission quoted the court, stating, “Section 3 supplies the Commission [with regulatory] flexibility far greater than would be the case were we to hold that imports are interstate commerce.”<sup>234</sup> The FERC then concluded,

In this case, the Commission will exercise its flexibility under NGA Section 3 to regulate the LNG import terminal as well as the [intrastate] pipeline facilities that will deliver gas into state regulated facilities downstream. . . . because the facilities at issue will have no other function than to receive and deliver imported gas from the terminal directly into local facilities.<sup>235</sup>

The Commission clarified that “the exemption [of intrastate facilities from federal regulation] contained in NGA Section 1(c) removes NGA jurisdiction over interstate commerce, but not over foreign commerce.”<sup>236</sup> Thus, the FERC ruled the intrastate facilities associated with the proposed terminal would be subject to the Commission’s section 3 jurisdiction.

On April 23 of 2004, the CPUC filed a request for rehearing of the Commission’s March 24 Order. On June 9, 2004, the Commission issued an order denying rehearing.<sup>237</sup> The CPUC then filed with the United States Court of Appeals for the District of Columbia Circuit a petition for review challenging the Commission’s orders. On September 20, 2004, the D.C. Circuit granted the FERC’s unopposed motion to transfer the CPUC’s petition for review to the U.S. Court of Appeals for the Ninth Circuit. As of the date of this report, the Ninth Circuit has yet to decide the appeal.

#### XVI. NOTICE OF INQUIRY REGARDING WHETHER FERC-REGULATED PARTNERSHIPS OR LIMITED LIABILITY COMPANIES CAN INCLUDE A CORPORATE INCOME TAX ALLOWANCE IN RATES

On December 2, 2004, the FERC issued a notice of inquiry seeking comments on a recent ruling by the United States Court of Appeals for the District of Columbia Circuit that may preclude FERC-regulated pipelines owned and operated by entities other than corporations (e.g., partnerships and limited liability companies) from including a corporate income tax allowance in their rates.<sup>238</sup> Specifically, on July 20, 2004, in *BP West Coast Products, LLC v. FERC*<sup>239</sup> (*BP*), the D.C. Circuit vacated and remanded the FERC’s inclusion, as

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232. *Id.*

233. *Sound Energy Solutions*, 106 F.E.R.C. ¶ 61,279, 62,017 (2004).

234. *Id.* at 62,018 (quoting *Distrigas*, 495 F.2d 1057, 1064).

235. 106 F.E.R.C. ¶ 61,279, at 62,018.

236. *Id.*

237. On August 5, 2004, the FERC issued an order clarifying its June 9 order with respect to the effect of its assertion of exclusive jurisdiction on California’s jurisdiction over certain environmental aspects of SES’s project. See *Sound Energy Solutions*, 108 F.E.R.C. ¶ 61,155 (2004).

238. See Notice of Inquiry, *Inquiry Regarding Income Tax Allowances; Request for Comments*, 69 Fed. Reg. 72,188 (2004).

239. *BP W. Coast Prods., LLC v. FERC*, 374 F.3d 1263 (D.C. Cir. 2004).

one element of the cost-of-service of oil pipeline SFPP, L.P. (SFPP), of an income tax allowance reflecting the interest held in SFPP by a subchapter 'C' corporation, SFPP, Inc. Because SFPP, Inc. held a percentage interest in SFPP, the Commission reasoned that its cost-of-service calculation for SFPP should include an allowance, equal to SFPP, Inc.'s ownership interest in the limited partnership, for income taxes that would have been incurred had the pipeline's jurisdictional earnings been subject to corporate taxation.<sup>240</sup>

Various shippers challenged the Commission's ruling, arguing that there was no rational basis for the FERC to approve an income tax allowance for a limited partnership since such entities incur no income tax liability.<sup>241</sup> As justification for its decision, the Commission cited the "double taxation" that occurs with respect to subchapter 'C' corporations, in which the corporation is subject to a corporate income tax, while its shareholders are individually liable for income tax on dividends generated by the corporation.<sup>242</sup> The FERC reasoned that, "because the corporate tax is an extra layer of taxation, the Commission includes an element for the corporate taxes in the [pipeline's] cost-of-service to insure that the [pipeline] has an opportunity to earn its allowed return on equity."<sup>243</sup> The Commission adhered to its established policy of permitting an income tax allowance for the corporate owners of a partnership, but not for the partnership's individual owners, on the basis that the individual owners do not pay a corporate income tax and thus are not burdened with double taxation.<sup>244</sup>

In rejecting the Commission's inclusion of an income tax allowance in SFPP's cost-of-service, the D.C. Circuit cited a leading case on the FERC's ratemaking authority, *FPC v. Hope Natural Gas Co.*,<sup>245</sup> in which the U.S. Supreme Court established the regulatory principle that the FERC (then the Federal Power Commission) "is to set rates in such a fashion that the regulated entity yields returns for its investors commensurate with returns expected from an enterprise of like risks."<sup>246</sup> The Court of Appeals pointed out that, had the corporate owners of SFPP "invest[ed] in a non-regulated entity of like risk and otherwise similar return, they would of course expect to pay their own corporate tax on any profit they might realize from that investment."<sup>247</sup> The court stated that the dual taxation the FERC attempted to address by including a corporate income tax allowance in SFPP's cost-of-service "is a product of the corporate form, not of the regulated or unregulated nature of the pipeline or any comparable investment or of the risks involved therein."<sup>248</sup> Thus, the court concluded, "where there is no tax generated by the regulated entity, either standing alone or as part of a consolidated corporate group, the regulator cannot

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240. *Id.* at 1287.

241. *BP W. Coast Prods., LLC*, 374 F.3d at 1286.

242. *Id.* at 1287.

243. *BP W. Coast Prods.*, 374 F.3d at 1287 (quoting *Lakehead Pipe Line Co.*, 71 F.E.R.C. ¶ 61,338, 61,314 (1995)).

244. *See id.* at 1288-90.

245. *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944).

246. *BP W. Coast Prods., LLC v. FERC*, 374 F.3d 1263, 1290 (D.C. Cir. 2004).

247. *Id.*

248. *BP W. Coast Prods., LLC*, 374 F.3d at 1291.

create a phantom tax in order to create an allowance to pass through to the rate payer."<sup>249</sup> The D.C. Circuit vacated the FERC's income tax allowance for SFPP and remanded the Commission's determination regarding the proper tax allowance for the limited partnership.<sup>250</sup>

The Commission intends that comments it received in response to its December 2 notice of inquiry will assist it in resolving those issues raised by the D.C. Circuit's *BP* ruling. Specifically, the Commission sought comments from interested persons on the scope of the D.C. Circuit's ruling, as well as input into the circumstances in which the Commission should permit an income tax allowance when setting cost-of-service rates for FERC-regulated companies.<sup>251</sup>

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249. *Id.*

250. *See BP W. Coast Prods., LLC*, 374 F.3d, 1263, 1312.

251. Comment of BP West Coast Products LLC and EXXONMOBILE Oil Corporation, *Inquiry Regarding Income Tax Allowances*, FERC Docket No. PL05-5-000 (2005).

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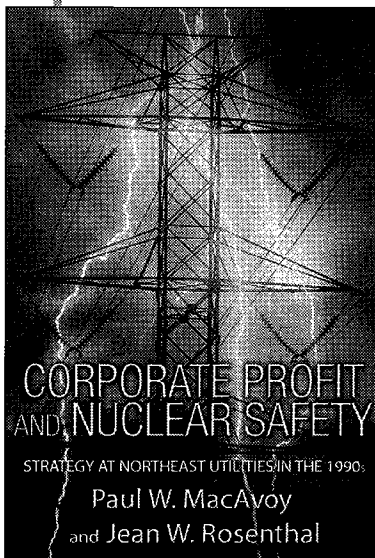
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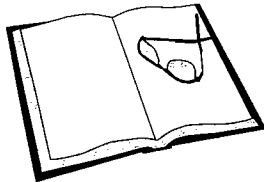


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