

# REPORT OF THE NATURAL GAS REGULATION COMMITTEE<sup>1</sup>

This report summarizes decisions and policy developments that have occurred in the area of natural gas regulation. The time frame covered by this report is July 1, 2006 to June 30, 2007.

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1. The Natural Gas Regulation Committee wishes to acknowledge the support of the full Committee in producing this report, and in addition, to recognize specific Committee members who made particular contributions to the report. Those members are Lawrence G. Acker and Mark M. Rabuano, Leboeuf, Lamb, Greene & MacRae, LLP; Christopher J. Barr, Post & Schell, PC; Glenn S. Benson, Fulbright & Jaworski LLP; Michael J. Fremuth, Andrews Kurth LLP; Marvin T. Griff and William F. Demarest, Blackwell Sanders LLP; Karin L. Larson, Hogan & Hartson LLP; Jason F. Leif and Peter I. Trombley, Jones Day; Tania S. Perez, King & Spalding LLP; Robert C. Platt, Fleischman & Walsh, LLP; Channing D. Strother, Jr., McCarthy, Sweeney & Harkaway, PC; and Richard G. Smead, Navigant Consulting Inc. This summary of natural gas regulatory developments is not meant to represent the views or positions of the contributors to this report, their clients, or their employers.

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## I. OVERSIGHT AND ENFORCEMENT

### A. Gas Standards of Conduct

#### 1. The D.C. Circuit Vacates and Remands Order 2004 in *National Fuel Gas Supply Corporation v. FERC*.

Following the issuance of expanded Standards of Conduct for affiliates of natural gas and electric power transmission providers in Order No. 2004,<sup>2</sup> natural gas pipelines and local distribution companies (LDCs) filed petitions for review in the United States Court of Appeals for the District of Columbia Circuit. In November 2006, the Court issued its decision in *National Fuel*.<sup>3</sup> The Court vacated and remanded Order No. 2004 as it applied to natural gas pipelines. Gas pipeline interests had challenged the rule broadly, particularly the extension of the Standards of Conduct to energy affiliates in addition to marketing affiliates.<sup>4</sup> No electric industry petitioners had challenged the rules, and thus the Standards of Conduct for electric transmission providers were not vacated.

The Court reviewed the background to the Standards of Conduct,<sup>5</sup> including the earlier standards established by Order No. 497 in 1988,<sup>6</sup> and affirmed by its decision in *Tenneco*.<sup>7</sup> According to the Court, Order No. 2004 made two fundamental changes from the Standards of Conduct applied under Order No. 497. First, the Court noted that the new Standards of Conduct expanded to govern not only pipeline marketing affiliates but “also pipelines’ relationships with numerous *non-marketing* affiliates-processors, gatherers, producers, local distribution

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2. Order No. 2004, *Standards of Conduct for Transmission Providers*, F.E.R.C. STATS. & REGS. ¶ 31,155 (2003), 68 Fed. Reg. 69,134 (2003) (to be codified at 18 C.F.R. pts. 37, 161, 250, 284, 358), *order on reh’g*, Order No. 2004-A, F.E.R.C. STATS. & REGS. ¶ 31,161 (2004), 107 F.E.R.C. ¶ 61,032 (2004), *order on reh’g*, Order No. 2004-B, F.E.R.C. STATS. & REGS. ¶ 31,166 (2004), 108 F.E.R.C. ¶ 61,118 (2004), *order on reh’g*, Order No. 2004-C, 109 F.E.R.C. ¶ 61,325 (2004), *order on reh’g*, Order No. 2004-D, 110 F.E.R.C. ¶ 61,320 (2005) [hereinafter Order No. 2004].

3. *National Fuel Gas Supply Corp. v. FERC*, 468 F.3d 831 (D.C. Cir. 2006).

4. Order No. 2004, *supra* note 2, at P 1. The decision did not reach the challenges made by LDC interests and by a pipeline challenging a narrow aspect of the rules.

5. *National Fuel*, 468 F.3d at 834-837.

6. Order No. 497, *Inquiry Into Alleged Anticompetitive Practices Related to Marketing Affiliates of Interstate Pipelines*, [Regs. Preambles 1986-1990] F.E.R.C. STATS. & REGS. ¶ 30,820 (1988), 53 Fed. Reg. 22,139 (1988); Order No. 497-A, *Inquiry into Alleged Anticompetitive Practices Related to Marketing Affiliates of Interstate Pipelines*, [Regs. Preambles 1986-1990] F.E.R.C. STATS. & REGS. ¶ 30,868 (1989), 54 Fed. Reg. 52,781 (1989); Order No. 497-B, *Inquiry into Alleged Anticompetitive Practices Related to Marketing Affiliates of Interstate Pipelines*, [Regs. Preambles 1986-1990] F.E.R.C. STATS. & REGS. ¶ 30,908 (1990), 55 Fed. Reg. 53,291 (1990); Order No. 497-C, *Inquiry into Alleged Anticompetitive Practices Related to Marketing Affiliates of Interstate Pipelines*, [Regs. Preambles 1991-1996] F.E.R.C. STATS. & REGS. ¶ 30,934 (1991), 57 Fed. Reg. 9 (1992), *reh’g denied*, 58 F.E.R.C. ¶ 61,139 (1992), 57 Fed. Reg. 5,815 (1992).

7. *Tenneco Gas v. FERC*, 969 F.2d 1187 (D.C. Cir. 1992).

companies, and traders.”<sup>8</sup> Second, the Court stated that the revised Standards of Conduct would govern “a pipeline’s relationships even with those affiliates that do not hold or control any capacity on the pipeline . . . [f]or example, a pipeline is subject to the Standards in its relationship with an affiliated producer that transports gas only on *other* pipelines.”<sup>9</sup> The Court then discussed in some detail the vigorous dissents filed by two Commissioners, emphasizing then-Commissioner Kelliher’s dissenting contention that “the flaw in the Standards of Conduct Final Rule is the lack of record evidence to support expanding the scope beyond Marketing Affiliates,” which led to the Commissioner’s conclusion that “suspicion is not a sufficient basis for expanding the scope of Standards of Conduct beyond Marketing Affiliates.”<sup>10</sup> In addition, the Court noted Commissioner Kelliher’s contention that evidence of abuse related to marketing affiliates failed to justify expansion of the Standards of Conduct to include non-marketing affiliates, and his concern that the effect would be to reduce efficiency without preventing unduly discriminatory behavior. The Court further noted Commissioner Brownell’s partial dissent regarding the absence of sufficient evidence to support extending the Standards of Conduct to previously exempt affiliated producers, gatherers and processors.<sup>11</sup>

Citing the agency’s obligation to articulate a basis for its rule in light of the record evidence, the Court examined the asserted record basis for the rule. The Court found Order No. 2004 justified on “an asserted theoretical threat of undue preferences and a claimed record of abuse,” rather than “solely on the theoretical danger.”<sup>12</sup> If the Federal Energy Regulatory Commission (FERC or Commission) could not support Order No. 2004 on the “claimed record evidence,”<sup>13</sup> the Court would not uphold it. As in *Tenneco*, the Court noted the consumer efficiencies arising from vertical integration, and further described *Tenneco* as standing “for the proposition that FERC cannot impede vertical integration between a pipeline and its affiliates without ‘adequate justification.’”<sup>14</sup> The Court largely affirmed Order No. 497 because it found that the FERC had properly relied upon both evidence of “(i) a plausible theoretical threat[s] of anti-competitive information-sharing between pipelines and their marketing affiliates and (ii) vast record evidence of abuse.”<sup>15</sup> In contrast, with respect to Order No. 2004 the Court concluded that the FERC erroneously based its actions on evidence of abuse by marketing affiliates, which were already subject to the Standards of Conduct, and upon record statements of a “theoretical potential for abuse.”<sup>16</sup> Agreeing with the Commission’s dissenters, the Court concluded,

Our review of the record on which FERC relied reveals that Commissioners Kelliher and Brownell were plainly correct: Unlike in Order No. 497, FERC here has provided no evidence of a real problem with respect to pipelines’ relationship with

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8. *National Fuel*, 468 F.3d at 838.

9. *Id.*

10. *National Fuel*, 468 F.3d at 838.

11. *Id.*

12. *National Fuel*, 468 F.3d at 839.

13. *Id.*

14. *National Fuel Gas Supply Corp. v. FERC*, 468 F.3d 831, 840 (D.C. Cir. 2006).

15. *Id.*

16. *National Fuel*, 468 F.3d at 841.

non-marketing affiliates. Indeed, Order 2004 does not include a single example of abuse by non-marketing affiliates.<sup>17</sup>

After reviewing and faulting as non-specific and hypothetical a number of record citations proffered by the FERC, the Court distinguished the record in Order No. 2004 with that in Order No. 497:

Here, by contrast [to *Tenneco*], FERC has cited *no* complaints and provided *zero* evidence of actual abuse between pipelines and their non-marketing affiliates. FERC staked its rationale in part on a record of abuse, but that record is non-existent. Professing that an order ameliorates a real industry problem but then citing no evidence demonstrating that there is in fact an industry problem is not reasoned decisionmaking.<sup>18</sup>

The FERC's other arguments on brief were dismissed. The Court specifically rejected the FERC's contention that complaints were absent because the activity was not prohibited under the Standards of Conduct before Order No. 2004, in light of the fact that the same argument could have been made of the conduct that gave rise to Order No. 497, an order which nonetheless was supported by extensive evidence of affiliate abuse; the Court noted that if affiliate abuse related to non-marketing affiliates had been "rampant, FERC likely would have been inundated with complaints and evidence, as it was before issuing Order 497."<sup>19</sup>

The Court discussed in some detail the potential courses of action that the FERC might follow in response to the order on remand, which included abandoning rules in this area or supporting its rules with evidence sufficient to meet the requirements established by *Tenneco*.<sup>20</sup> The Court noted that the FERC might attempt to support the rule by making "its best case for relying *solely* on a theoretical threat of abuse," and in the event that the FERC took that path, the Court provided detailed commentary on the nature and contents such a justification would need to encompass.<sup>21</sup> The Court did not speculate whether an order addressing these factors could justify the vacated rule on the basis of theoretical harm alone, but provided the guidance as illustrative of the necessary analysis.

## 2. The FERC issues its *Interim Rule*, Order No. 690.

On January 9, 2007, the FERC issued its Interim Rule<sup>22</sup> to govern the Standards of Conduct following the Court decision in *National Fuel*,<sup>23</sup> which was to govern transmission providers' affiliate relationship until the effective date of permanent regulations to be adopted in a separate rulemaking. The FERC issued the Interim Rule without notice or comment to ensure certainty while the FERC considers a Final Rule. Broadly, the Interim Rule retained Part 358 of the FERC's regulations and re-promulgated those rules in Order No. 2004 that were

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17. *Id.* at 841.

18. *National Fuel*, 468 F.3d at 843.

19. *Id.* at 844.

20. *National Fuel Gas Supply Corp. v. FERC*, 468 F.3d 831, 844 (D.C. Cir. 2006).

21. *Id.*

22. Order No. 690, *Standards of Conduct for Transmission Providers*, F.E.R.C. STATS. & REGS. ¶ 31,237 (2007), 72 Fed. Reg. 2,427 (2007) [hereinafter Order No. 690]. The FERC also issued an order correcting an error in this order on January 19, 2007. Errata Notice, *Standards of Conduct for Transmission Providers*, Docket No. RM07-6-000 (Jan. 22, 2007).

23. The *National Fuel* decision is discussed *supra* in Section I.A.1.

not challenged on appeal. With respect to elements of Part 358 that were challenged on appeal, the Interim Rule temporarily reestablished the standards of conduct promulgated under Order No. 497. In effect, the FERC sought to retain a version of Order No. 2004 modified to omit those portions that were challenged in the *National Fuel* case. As a result, the revised Part 358 only changed regulations applicable to natural gas Transmission Providers and their affiliates.<sup>24</sup>

The Interim Rule effected a number of modifications: (1) gas pipeline “energy affiliates” were exempted from Part 358 restrictions;<sup>25</sup> (2) the term “Marketing Affiliates” was redefined to “mirror” the definition as it existed under Order No. 497;<sup>26</sup> (3) the Interim Rule removed the restrictions on shared risk management activities and employees of energy and marketing affiliates of natural gas pipelines;<sup>27</sup> (4) the requirement to post all discretionary acts was revised to apply instead the Order No. 497 requirement on gas pipeline transmission providers, which required them only to post actions under tariff provisions providing for waivers;<sup>28</sup> (5) as to gas pipelines, participating in business decisions by rendering legal advice would not make a lawyer a transmission function employee, so that lawyers would be permissibly shared employees;<sup>29</sup> and (6) new pipelines would become subject to the Standards of Conduct when they commence transportation transactions with their marketing affiliates (the Order No. 497 standard), rather than when they began soliciting business or negotiating contracts.<sup>30</sup>

3. Order No. 690-A, on clarification and rehearing of Order No. 690.

On March 21, 2007, the FERC issued Order No. 690-A, Order on Clarification and Rehearing,<sup>31</sup> clarifying in part its Interim Rule, but deferring certain matters to the rulemaking proceeding addressing a permanent rule for the Standards of Conduct. Parties had requested clarification and/or rehearing on five issues. The FERC elected to address two of those issues immediately:

[T]he standards of conduct will not govern the relationship of a natural gas transmission provider and its affiliate that engages in marketing or brokering activities (as defined in § 358.3(l)) if that affiliate does not conduct transportation transactions on that natural gas transmission provider’s pipeline. Also the standards of conduct do not govern the relationship between a natural gas transmission provider and its electric affiliate that engages in electric marketing, sales or brokering activities (as defined in § 358.3(e)) as long as that electric affiliate does not: (i) engage in

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24. Order No. 690, *supra* note 22, at PP 1-3.

25. *Id.* at PP 14-17.

26. Order No. 690, *supra* note 22, at P 18. The Interim Rule provided two different “marketing” definitions, but the FERC’s *Errata Notice* issued on January 22 clarified that the language discussed at P 18 would modify the definition of “marketing affiliate” as described by the Preamble (i.e., that marketing affiliates of gas pipelines would remain subject to the Standards of Conduct). *Errata Notice, supra* note 22.

27. Order No. 690, *supra* note 22, at PP 19-20.

28. *Id.* at PP 21-23.

29. Order No. 690, *supra* note 22, at PP 24-25.

30. *Id.* at P 26.

31. Order No. 690-A, *Standards of Conduct for Transmission Providers*, F.E.R.C. STATS. & REGS. ¶ 31,243 (2007), 72 Fed. Reg. 14,235 (2007) [hereinafter Order No. 690-A].

natural gas marketing activities under § 358.3(l), and (ii) conduct transportation transactions on the affiliated natural gas transmission provider's pipeline.<sup>32</sup>

The FERC Commission concluded that the other matters raised by the requests went beyond restoring the status quo under Order No. 497 to issues not appealed in the *National Fuel* case, and hence deferred addressing them to the rulemaking.<sup>33</sup> The Commission also issued an errata order to Order No. 690-A.<sup>34</sup>

4. Notice of Proposed Rulemaking, *Standards of Conduct*, Docket No. RM07-1-000.

On January 18, 2007, the FERC issued a Notice of Proposed Rulemaking (NOPR)<sup>35</sup> proposing permanent amended Standards of Conduct in response to *National Fuel*. The NOPR also sought to incorporate regulatory changes addressed during the FERC's outreach efforts regarding the Standards of Conduct and subsequent public input during 2006.<sup>36</sup> In the NOPR, the FERC generally proposed revised regulations that would incorporate the elements of the Interim Rule.<sup>37</sup> The new rules would make permanent many provisions of Part 358 and the Standards of Conduct that were not challenged in the court appeal, but would remove natural gas transmission providers' energy affiliates from inclusion in the Standards of Conduct, and would revise the definition of gas pipelines' "marketing affiliates" to be broadly the same as the definition under Order No. 497.<sup>38</sup> One exception was proposed, in that gas transmission providers' affiliated asset managers would be considered "marketing affiliates" subject to the Standards of Conduct.<sup>39</sup> In addition, the NOPR solicited input as to whether the rules should make parallel and consistent changes with respect to electric transmission providers.<sup>40</sup> The NOPR also proposed a number of changes to the regulations not required by the court decision, particularly regarding Integrated Resource Planning.<sup>41</sup> The NOPR also proposed to adopt permanent rules incorporating the changes adopted in the Interim Rule for § 358.4(a)(6) of the Commission's regulations regarding risk management employees and §§ 358.5(c)(4)(i) and (ii) of the Commission's regulations regarding discretionary waivers, and with respect to the time at which Standards of Conduct apply to new gas pipelines.<sup>42</sup> As a corollary change, the NOPR proposed to remove §

32. *Id.* at P 14.

33. Order No. 690-A, *supra* note 31, at P 15.

34. Errata Notice, *Standards for Transmission Providers*, Docket No. RM07-6-001 (May 3, 2007).

35. Notice of Proposed Rulemaking, *Standards of Conduct for Transmission Providers*, F.E.R.C. STATS. & REGS. ¶ 32,611 (2007), 72 Fed. Reg. 3,958 (2007) [hereinafter NOPR].

36. *Id.* at PP 32-33.

37. NOPR, *supra* note 35, at PP 9-15. The provisions of the Interim Rule are discussed *supra* at Section I.A.2.

38. NOPR, *supra* note 35, at P 3. The FERC did request comments as to whether repromulgation of the rules without applying Part 358 to gas pipelines' energy affiliates "is sufficient to protect customers." *Id.* at P 10.

39. NOPR, *supra* note 35, at PP 21-22.

40. The FERC raised specific questions regarding whether energy affiliates of electric transmission providers should be subject to the Standards of Conduct and whether the final rule should retain the Order Nos. 889/2004 scope of "marketing affiliate" for electric transmission providers while reverting to Order No. 497 as to natural gas transmission providers' marketing affiliates. NOPR, *supra* note 35, at PP 11-20.

41. *Id.* at P 25.

42. NOPR, *supra* note 35, at PP 23-30.

358.5(b)(8) of the Commission's regulations, which permits the transmission provider to share information necessary to maintain the operations of its transmission system with its energy affiliates, in light of the change in status of natural gas pipelines' energy affiliates.<sup>43</sup>

As a result of public outreach and subsequent input from the industry, the NOPR also proposed to add and revise various sections in a manner that would "relax the standards of conduct to facilitate integrated resource planning and competitive solicitations."<sup>44</sup> The goal of these changes was to improve coordination between transmission, planning, and demand response programs. The newly created category of "planning employees" would be able to receive transmission data in order to conduct state-mandated integrated resource planning; similarly, a new category of "competitive solicitation employees" would be permitted to conduct competitive solicitations and interact with transmission personnel to evaluate related proposals.<sup>45</sup>

The NOPR also proposed various other changes, including requiring each transmission provider to post the name of its chief compliance officer, deleting certain outdated references, requiring that transmission provider employees certify that they have completed standards of conduct training, and revising the definition of affiliate regarding exempt wholesale generators.<sup>46</sup>

#### *B. Policy Statement In PL05-10 On Offshore Gathering Companies Acting In Concert With Interstate Pipelines*

In its Order Terminating Proceeding and Clarifying Policy (Policy Statement), the FERC Commission set forth its policy on reasserting jurisdiction over gathering services of affiliates of natural gas pipelines.<sup>47</sup> The Policy Statement was a direct result of the decision handed down in *Williams Gas Processing - Gulf Coast Company, LP v. FERC (Williams)*.<sup>48</sup> In that case, the United States Court of Appeals for the District of Columbia Circuit vacated and remanded Commission orders in which the Commission had sought to reassert jurisdiction over certain affiliated gathering activities under the criteria set forth in *Arkla Gathering Service Company*.<sup>49</sup> The court held that the Commission had not met its own test under *Arkla* for reassertion of jurisdiction.<sup>50</sup>

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43. *Id.* at P 31.

44. NOPR, *supra* note 35, at P 36.

45. *Id.* at PP 32-60.

46. NOPR, *supra* note 35, at P 64.

47. *Criteria for Reassertion of Jurisdiction Over the Gathering Services of Natural Gas Company Affiliates*, 118 F.E.R.C. ¶ 61,114 (2007) [hereinafter Policy Statement].

48. *Williams Gas Processing-Gulf Coast Co. v. FERC*, 373 F.3d 1335 (D.C. Cir. 2004).

49. *Arkla Gathering Services Co.*, 67 F.E.R.C. ¶ 61,257 (1994), *order on reh'g*, 69 F.E.R.C. ¶ 61,280 (1994), *reh'g denied*, 70 F.E.R.C. ¶ 61,079 (1995), *reconsideration denied*, 71 F.E.R.C. ¶ 61,297 (1995) (collectively, *Arkla*), *aff'd in part and reversed in part*, *Conoco Inc. v. FERC*, 90 F.3d 536 (D.C. Cir. 1996). In *Arkla*, the Commission set out its policy regarding affiliate "spin off" and "spin down" transactions. Under that policy, the Commission stated that although it generally lacks jurisdiction over affiliates that only perform gathering services, it would exert control over the gathering activities of affiliates in particular circumstances where such action is considered necessary to accomplish the Commission's policies for the transportation of natural gas in interstate commerce. 67 F.E.R.C. ¶ 61,257, at 61,870-71.

50. *Williams*, 373 F.3d at 1338.



In the Policy Statement, the Commission stated that it would keep, but clarify, the *Arkla* test.<sup>51</sup> In particular, the Commission announced that it may assert jurisdiction over an affiliate gatherer when the gatherer has used its market power over gathering to benefit the pipeline in its performance of jurisdictional transportation or sales service and when that benefit is contrary to the Commission's policies concerning jurisdictional services adopted pursuant to the Natural Gas Act (NGA).<sup>52</sup> The Commission also said it would assert jurisdiction over a gathering affiliate if it is using anti-competitive behavior to benefit the pipeline.<sup>53</sup>

The Commission determined that a finding of "concerted action" is not a necessary prerequisite to an assertion of jurisdiction.<sup>54</sup> The Commission decided against requiring natural gas gathering facilities to act independently of pipelines in order to be exempt from the Commission's jurisdiction as some had urged.<sup>55</sup> The Commission clarified that it did not consider it necessary to assert jurisdiction just because a pipeline gives transportation discounts based on the use of its gathering affiliate's services.<sup>56</sup> On the other hand, the Commission could assert jurisdiction where the gathering affiliate is offering discounts in connection with contracts for pipeline transportation service.<sup>57</sup> The Commission said it would examine any improper shifting of costs between the pipeline and its gathering affiliate in a rate proceeding.<sup>58</sup>

The Commission also confirmed that it would continue to rely on the current primary function test for application to offshore facilities.<sup>59</sup> The Commission said that although it may take into account non-physical factors in its determination, these non-physical factors would be of secondary importance to the physical factors.<sup>60</sup>

### C. FERC Policy and Process for Assessing Civil Penalties

On December 21, 2006, the Commission issued a Statement of Administrative Policy<sup>61</sup> (Administrative Process Policy Statement), to provide guidance on the process by which civil penalties may be assessed by the Commission. This is the Commission's third step in implementing its expanded enforcement authority under the Energy Policy Act of 2005 (EPAAct 2005).<sup>62</sup> The EPAAct 2005 substantially increased the Commission's civil penalty authority to permit the Commission to assess civil penalties of up to \$1 million per day for violations of the

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51. Policy Statement, *supra* note 47, at P 35.

52. *Id.* at P 51.

53. Policy Statement, *supra* note 47, at P 13.

54. *Id.* at P 63.

55. Policy Statement, *supra* note 47, at P 73.

56. *Id.* at P 61.

57. Policy Statement, *supra* note 47, at P 61.

58. *Id.*

59. Policy Statement, *supra* note 47, at P 82.

60. *Id.* at P 89.

61. *Process for Assessing Civil Penalties*, 117 F.E.R.C. ¶ 61,317 (2006) [hereinafter Administrative Policy Statement].

62. Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594 (2005) [hereinafter Energy Policy Act].

Federal Power Act (FPA), the Natural Gas Act, and the Natural Gas Policy Act of 1978.<sup>63</sup>

The Commission noted in the Administrative Process Policy Statement that in many enforcement actions, civil penalties are negotiated as part of a stipulation and agreement resolving compliance issues. In such instances, the penalty is imposed through a Commission order approving the agreement and an assessment process is unnecessary.<sup>64</sup> While the Commission emphasizes that it continues to encourage settlement, it also recognizes that not all enforcement actions will settle. In those cases, an assessment process is necessary to enable the public and regulated community to understand the civil penalty process that will be followed under each statute.<sup>65</sup>

Pursuant to the Administrative Process Policy Statement, the Commission will begin all enforcement actions in a uniform manner, although the specific civil penalty processes will differ depending on the statute invoked.<sup>66</sup> Under the new assessment process, the Commission first will issue a notice of the proposed penalty providing a statement of material facts describing the violation.<sup>67</sup> Although the precise steps that the Commission follows vary according to the relevant acts, at some point in the assessment process the entity that is the subject of the enforcement proceeding will have an opportunity to respond with information that could justify reducing, modifying, or eliminating the proposed penalty. Nonetheless, depending on the act the enforcement order falls under, entities being assessed civil penalties will have an opportunity for a hearing before the Commission, review *de novo* in a United States District Court, or appeal of final orders assessing penalties to the United States Court of Appeals.<sup>68</sup>

Chairman Kelliher stated that the Administrative Process Policy Statement demonstrates the Commission's "continued commitment to firm but fair enforcement."<sup>69</sup> The Commission also took the opportunity in issuing the Administrative Process Policy Statement to reemphasize that it encourages companies to develop a culture of compliance and to self-report violations.<sup>70</sup>

#### *D. Bangor Gas Company, LLC, 118 FERC ¶ 61,186 (2007)*

On March 7, 2007, the Commission approved its first civil penalty for violations of the Commission's natural gas rules since Congress granted the agency increased penalty authority under the EPAct 2005. The Commission approved a stipulation and consent agreement with Bangor Gas Company, LLC (Bangor) that included a civil penalty of \$1 million and the submission of semi-annual compliance reports. Bangor self-reported to the Commission that it had

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63. *Id.* § 314(b).

64. Administrative Policy Statement, *supra* note 61, at P 2.

65. *Id.*

66. Administrative Policy Statement, *supra* note 61, at P 4.

67. *Id.* at P 5.

68. Administrative Policy Statement, *supra* note 61, at P 12.

69. Joseph T. Kelliher, Chairman, FERC, Statement on Process for Assessing Civil Penalties, 2 (Dec. 21, 2006), <http://elibrary.ferc.gov/idmws/nvcommon/NVViewer.asp?Doc=11213166:0>.

70. Administrative Process Policy Statement, *supra* note 61, at P 1.

violated the Commission's "shipper-must-have-title" rule.<sup>71</sup> That rule requires shippers to hold title to the gas they are transporting using their own capacity.

The violations were uncovered during a due diligence investigation by Bangor's ultimate parent, Sempra Energy, conducted pursuant to the potential sale of Bangor. After Sempra conducted an internal investigation into the violations, it submitted a written self-report to the FERC's Enforcement Staff and cooperated with the Staff during its six year investigation.<sup>72</sup>

The report stated that Bangor had used its contract with Maritimes and Northeast Pipeline (MNE) to transport gas owned by third parties. According to the report, Bangor did not hold title to the gas it transported for nine customers on 1.5 miles of the Maritimes and Northeast Pipeline located in Maine.<sup>73</sup> The report also stated that Bangor's personnel responsible for nominating and scheduling gas on MNE were not aware of the Commission's rule or the MNE tariff section which implemented the Commission's rule and Order No. 636.<sup>74</sup> In addition, Bangor had no compliance or training program in place that addressed this issue.<sup>75</sup>

In assessing Bangor a civil penalty under the Commission's Policy Statement on Enforcement,<sup>76</sup> the Commission acknowledged the Staff's finding that the MNE was not constrained and that Bangor's actions did not generate a profit or cause financial harm to third parties.<sup>77</sup> The Commission stated that Bangor's cooperation, prompt submission of the self-report, and the small geographic area in which the transactions were involved benefited the company and kept the penalty on the lower end of the range of possibilities.<sup>78</sup> However, said the Commission, the failure of the company's senior management to ensure that personnel complied with the rule exacerbated the violation of the rule itself.<sup>79</sup>

#### *E. Proposed Changes to Gas Reporting Requirements*

On April 19, 2007, the Commission issued a NOPR,<sup>80</sup> which expands the current rules related to reporting price and transaction data. The revised reporting requirements demonstrate the Commission's expanded authority under section 23 of the NGA, which was added by the EAct 2005.<sup>81</sup>

##### 1. Background

As part of the EAct 2005, Congress charged the Commission with ensuring the integrity of wholesale natural gas and electricity markets through facili-

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71. *In re Bangor Gas Co., LLC*, 118 F.E.R.C. ¶ 61,186, at P 4 (2007).

72. *Id.* at PP 4-5.

73. 118 F.E.R.C. ¶ 61,186, at P 10.

74. *Id.* at P 11.

75. *Bangor*, 118 F.E.R.C. ¶ 61,186, at P 11.

76. *Enforcement of Statutes, Orders, Rules, and Regulations*, 113 F.E.R.C. ¶ 61,068 (2005).

77. 118 F.E.R.C. ¶ 61,186, at P 12.

78. *Id.*

79. 118 F.E.R.C. ¶ 61,186, at P 12.

80. Notice of Proposed Rulemaking, *Transparency Provisions of Section 23 of the Natural Gas Act; Transparency Provisions of the Energy Policy Act*, F.E.R.C. STAT. & REGS. ¶ 35,516, 72 Fed. Reg. 20,791 (2007) [hereinafter *Transparency Provisions*].

81. Energy Policy Act, *supra* note 62.

tating price transparency.<sup>82</sup> The NOPR makes three significant changes to the current reporting requirements. First, the NOPR would require intrastate pipelines to post daily the capacities of, and volumes flowing through, their major receipt and delivery points and mainline segments.<sup>83</sup> Second, the proposed rule would require that all buyers and sellers of more than a *de minimis*<sup>84</sup> volume of natural gas report, annually, numbers and volumes of relevant transactions to the Commission.<sup>85</sup> Third, the NOPR would require each holder of a blanket marketing certificate or a blanket unbundled sales service certificate to notify the Commission annually whether it reports its transactions to publishers of price indices and whether its reporting complies with the Commission's standards currently set forth in the Policy Statement on Natural Gas and Electric Price Indices.<sup>86</sup> Notably, the Commission declined to mandate reporting of all fixed-price transactions. Each of the proposed requirements are discussed in more detail below.

## 2. The Proposal

Currently, interstate pipelines post information regarding the daily scheduled flow of natural gas. The Commission has determined that daily intrastate data also is needed to provide a complete picture of natural gas flows in the United States. Accordingly, the Commission proposes to require intrastate pipelines to post daily, actual flow information.<sup>87</sup> Because intrastate pipelines operate in different regulatory and business contexts than interstate pipelines, the Commission determined that it is more useful to obtain actual flow data from intrastate pipelines as opposed to scheduled volume data.<sup>88</sup>

The second proposal in the NOPR is to require buyers and sellers of a significant volume of natural gas to report aggregate numbers and volumes of relevant transactions in an annual electronic filing to the Commission.<sup>89</sup> This proposed annual reporting requirement is significant in that it would apply to companies traditionally within the Commission's jurisdiction as well as non-jurisdictional buyers and sellers of natural gas who now fall within the Commission's "transparency authority" under the EAct 2005.<sup>90</sup> The Commission intends to use the annual reports to estimate the size of the physical domestic natural gas market, assess the importance of the use of index pricing in that market, and determine the size of the fixed-price trading market that produces the information.<sup>91</sup>

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82. *Id.* § 316.

83. *Transparency Provisions*, *supra* note 80, at P 2.

84. A *de minimis* participant is any buyer or seller whose physical natural gas transactions amount to less than 2,200,000 MMBtus for the previous calendar year. 18 C.F.R. § 284.402 (2007).

85. *Transparency Provisions*, *supra* note 80, at P 3.

86. *Id.*; *Price Discovery in Natural Gas and Electric Markets*, 104 F.E.R.C. ¶ 61,121 (2003); *Price Discovery in Natural Gas and Electric Markets*, 105 F.E.R.C. ¶ 61,282 (2003); *Price Discovery in Natural Gas and Electric Markets*, 112 F.E.R.C. ¶ 61,040 (2005).

87. *Transparency Provisions*, *supra* note 80, at P 2.

88. *Id.* at P 32.

89. *Transparency Provisions*, *supra* note 80, at P 3.

90. *Id.* at P 14.

91. *Transparency Provisions*, *supra* note 80, at P 3.

The last proposed change to the reporting requirements would shift a blanket certificate holder's requirement to notify the Commission regarding its index reporting practices from the current practice of providing letter notification of any change to an annual statement.<sup>92</sup> Under the current requirements, companies that hold a blanket market certificate or blanket unbundled sales service certificate made an initial filing notifying the Commission whether they voluntarily report their transactions to price index publishers. After this initial notification, certificate holders need only notify the Commission when they change their reporting practices.<sup>93</sup> The NOPR expands this reporting requirement to require certificate holders to inform the Commission annually whether they voluntarily report transaction data to index publishers.<sup>94</sup> This annual notification will be incorporated into the annual report form used to report the aggregate natural gas transaction data.<sup>95</sup>

## II. RATES

### A. *ROE Decision in Kern River Rate Case*

On October 19, 2006, the Commission issued Opinion No. 486 in Kern River Gas Transmission Company (Kern River).<sup>96</sup> Pertinent to the rate discussion here, the Commission, in Opinion No. 486, reversed the Administrative Law Judge's (ALJ) finding that Kern River should be accorded a return on equity of 9.34%.<sup>97</sup> Instead, by accepting certain arguments raised by Kern River (on exceptions to the ALJ's decision), and by following or interpreting some of its own precedents, the Commission adopted an 11.2% return on equity (ROE) for Kern River.<sup>98</sup> The two main issues on which the Commission differed with the ALJ were (1) the composition of the proxy group used to derive the range of reasonable returns on equity for a natural gas pipeline, and (2) the placement of Kern River within that range of reasonable returns.<sup>99</sup>

The Commission uses the Discounted Cash Flow (DCF) methodology to set the return on equity for cost-based rates for natural gas pipelines. As part of the DCF methodology, the Commission must determine the short-term growth projection for investments in natural gas pipelines.<sup>100</sup> To determine the short-term growth projection, the Commission establishes a range of reasonable estimates of such growth based on the Institutional Brokers' Estimate System (IBES) growth projections for selected natural gas pipeline companies.<sup>101</sup> The group of companies chosen comprises the "proxy group" used in the DCF method. Because the selection of companies to be included in the proxy group can result in a

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92. *Id.* at 46.

93. *Transparency Provisions*, *supra* note 80, at P 3.

94. *Id.* at P 46.

95. *Transparency Provisions*, *supra* note 80, at P 68.

96. Opinion No. 486, *Kern River Gas Transmission Co.*, 117 F.E.R.C. ¶ 61,077 (2006) [hereinafter Opinion No. 486].

97. *Id.* at P 2.

98. Opinion No. 486, *supra* note 96, at P 2.

99. *Id.* at P 122.

100. Opinion No. 486, *supra* note 96, at P 121.

101. *Id.*

significantly different range of reasonable ROEs compared to a different selection, the composition of the proxy group was a highly-contested issue in the Kern River proceeding.<sup>102</sup>

In Opinion No. 486, the Commission chose Kinder Morgan Inc. (Kinder Morgan), Equitable Resources, Inc. (Equitable Resources), National Fuel Gas Company (National Fuel), and Questar Gas Company (Questar) to comprise the proxy group.<sup>103</sup> These four companies are the same four companies that the Commission chose to comprise the proxy group in its prior decision concerning ROE for a gas pipeline.<sup>104</sup> At the same time that the Commission chose these four proxy companies, the Commission recognized that it is becoming increasingly difficult for the Commission to compile a sufficiently large number of appropriate companies for inclusion in the DCF proxy group because fewer and fewer gas pipeline companies meet the historical criteria for inclusion.<sup>105</sup> The historical criteria are: (1) publicly-traded stock; (2) stock tracked by an investment information service; and (3) a high proportion of revenues from gas pipeline operations.<sup>106</sup> The Commission admitted in Opinion No. 486 that “[t]he four-company proxy group we have adopted in this case contains only one company with a sufficiently high proportion of pipeline business to satisfy our traditional proxy group standards.”<sup>107</sup>

The problem of an insufficient number of gas pipeline companies able to meet the Commission’s traditional proxy group standards was caused in part in this case (according to the Commission) by the fact that the 2002-2004 financial difficulties for El Paso Corporation (El Paso) and the Williams Companies (Williams) made the IBES projections for these pipeline companies that were available to put into evidence at the hearing “too low to be credible.”<sup>108</sup> Absent these difficulties, it would appear that the Commission would include El Paso and Williams in future proxy groups for gas pipeline ROE determinations.<sup>109</sup> Another cause for the difficulty in finding suitable proxy companies is that ownership of many gas pipelines has evolved into the master limited partnership (MLP) form. The Commission in Opinion No. 486 found that inclusion of MLP-owned pipelines in the DCF proxy group in a case concerning a non-MLP pipeline is inappropriate because there are significant differences between MLPs and non-MLPs as investment vehicles.<sup>110</sup>

On the topic of using MLP-owned pipelines in the proxy group in the Kern River case, it should be emphasized that Kern River is a general partnership that “is ultimately owned by a corporation,” and the Commission stated that “[f]or ratemaking purposes, we are treating Kern River as a corporation.”<sup>111</sup> Thus,

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102. Opinion No. 486, *supra* note 96, at P 125.

103. *Id.* at P 138.

104. Opinion No. 486, *supra* note 96, at P 138; *See also High Island Offshore System, LLC*, 110 F.E.R.C. ¶ 61,043, *reh’g*, 112 F.E.R.C. ¶ 61,050 (2005) [hereinafter *HIOS*].

105. Opinion No. 486, *supra* note 96, at P 139.

106. *Id.* at P 123.

107. Opinion No. 486, *supra* note 96, at P 173.

108. *Id.* at P 140 (quoting a Commission Staff witness).

109. The Commission declined to reopen the record to accept more recent IBES projections for El Paso and Williams. Opinion No. 486, *supra* note 96, at P 157.

110. *Id.* at P 143.

111. Opinion No. 486, *supra* note 96, at P 143.

Kern River's proposal to include MLP-owned pipelines in the proxy group confronted Kern River with the need to explain and harmonize investment service growth projections for MLP-owned pipeline distributions with investment service growth projections for corporate pipeline dividends.<sup>112</sup> Absent that harmonization, the various short-term growth rates reflected in the proxy group returns would, essentially, compare apples with oranges.<sup>113</sup> The Commission noted that MLP distributions differ from corporate dividends, and stated that "Kern River has not provided an adequate explanation concerning the short term growth patterns of its proposed MLPs" sufficient to include them on an apples-to-apples basis in the proxy group appropriate for Kern River, i.e., a proxy group of corporate-owned pipelines.<sup>114</sup> The Commission did state, however, as to future determinations of ROE in gas pipeline rate cases, that "we do not intend in this order to foreclose non-MLP pipelines from proposing to include MLPs in the proxy group."<sup>115</sup> Moreover, as to the possibility of using combined gas and electric companies in the proxy group for gas pipelines' ROE determinations, the Commission again signaled some leeway in future cases. The Commission noted that "as the natural gas industry continues to evolve, and if electric and gas companies continue to combine," the Commission may revisit the issue of allowing combined gas and electric companies in the DCF proxy group.<sup>116</sup>

As to the placement of Kern River within the range of reasonable returns determined by the proxy group chosen by the Commission, the Commission in Opinion No. 486 deviated from its existing policy of presuming that all pipelines have similar average risk and thus placing each pipeline at the median of the DCF range of returns.<sup>117</sup> In Opinion No. 486, the Commission instead located Kern River's ROE in the upper end of the DCF range of returns. The Commission made this choice because the proxy group included Equitable Resources and National Fuel, whose businesses are composed mainly of gas distribution operations that are lower risk than gas pipeline operations.<sup>118</sup> Because lower risk equates to lower expected return, the inclusion of Equitable Resources and National Fuel skewed the DCF range of returns downward. The Commission found it "appropriate to account for this difference" in the risk profile of Kern River compared to the risk profile of the proxy group companies by adjusting Kern River's placement in the DCF range of returns.<sup>119</sup> The Commission accomplished the adjustment by adding fifty basis points to the proxy group median return of 10.7%, resulting in Commission approval of an 11.2% ROE for Kern River.<sup>120</sup>

The Commission stated that when comparing one to another, pipelines generally fall into a broad range of average risk, and so the presumption will remain

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112. *Id.* at PP 148-153.

113. Opinion No. 486, *supra* note 96, at P 152.

114. *Id.*

115. Opinion No. 486, *supra* note 96, at P 154.

116. *Id.* at P 159.

117. Opinion No. 486, *supra* note 96, at P 171.

118. *Id.* at PP 129-130.

119. Opinion No. 486, *supra* note 96, at P 161.

120. *Id.* at P 175.

that a pipeline will be placed at the median of the DCF range of returns.<sup>121</sup> To place the pipeline higher or lower than the median, the Commission will continue to apply its existing policy of determining whether the pipeline is more or less risky than other pipelines.<sup>122</sup> However, due to the difficulty (described above) of composing a sufficiently large proxy group of non-MLP-owned pipeline companies, and the resulting DCF group that contained companies with a relatively low proportion of pipeline business and substantial distribution operations, the Commission recognized that use of the median “will tend to understate the required return on equity for the pipeline business.”<sup>123</sup> Thus, in future cases, if the Commission uses the same proxy group that it used in Opinion No. 486, it may be inclined to place the pipeline’s ROE above the median of the proxy group.

### B. *Income Tax Allowance in Kern River Rate Case*

As part of setting Kern River’s overall return in Opinion No. 486, the Commission had to decide the basis on which to compute the income tax allowance in Kern River’s rates. The backdrop to the case was the D.C. Circuit’s remand (and criticism) of a Commission decision granting a full income tax allowance to an oil pipeline that was part of an MLP,<sup>124</sup> and the Commission’s Policy Statement in response to the D.C. Circuit’s remand.<sup>125</sup> The D.C. Circuit’s *BP West Coast* decision cast doubt on whether a non-corporate pipeline is entitled to an income tax allowance in rates, but the Commission’s Policy Statement stated that an income tax allowance would be permitted whenever the pipeline could show that its owner incurs an actual or potential income tax liability.<sup>126</sup> Against this backdrop, the ALJ had determined that Kern River was a non-corporate pipeline and not carried its burden of proving that its owners faced an actual or potential income tax liability, and had denied Kern River any income tax allowance.<sup>127</sup>

The Commission reversed the ALJ. The Commission determined that Kern River is entitled to the full tax allowance accorded any Subchapter C corporate pipeline.<sup>128</sup> The Commission emphasized that the income tax allowance issues as to MLP-owned pipelines that are addressed by *BP West Coast* and the Policy Statement are “irrelevant” as to Kern River.<sup>129</sup> In that regard, the Commission noted that “while Kern River is structured as a pass-through entity consisting of partnerships and limited liability corporations, each of its elements is taxed as a

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121. Opinion No. 486, *supra* note 96, at P 175.

122. *Id.*

123. Opinion No. 486, *supra* note 96, at P 171.

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

125. *Policy Statement on Income Tax Allowances*, 111 F.E.R.C. ¶ 61,139, *reh’g dismissed*, 112 F.E.R.C. ¶ 61,203 (2005) [hereinafter *Tax Policy Statement*].

126. *Id.* at P 1. The backdrop against which the Kern River case was tried has changed, and has been simplified in favor of granting full income tax allowances to most if not all pipelines, by the D.C. Circuit’s subsequent decision on the income tax allowance issue in *ExxonMobil Oil Corporation*. *ExxonMobil Oil Corp. v. FERC*, 487 F.3d 945 (D.D.C. 2007).

127. Opinion No. 486, *supra* note 96, at P 212.

128. *Id.* at P 219.

129. Opinion No. 486, *supra* note 96, at P 220.



corporation.”<sup>130</sup> Thus, the Commission treated Kern River effectively as a corporate-owned pipeline.

Moreover, the fact that Kern River could show no actual tax payment by it in the test period of the case (or in succeeding months) did not require a different result. The Commission explained that its tax allowance policy for corporate pipelines has always sought to put in rates allowances for “actual or estimated taxes paid *or incurred*,” not just for actual taxes.<sup>131</sup> Once timing and normalization issues worked their way through the tax scheme, the Commission noted, Kern River would have incurred tax liability for the rate period at issue.<sup>132</sup>

### C. *New York PSC v. National Fuel Gas Supply Corporation*

On February 9, 2007, the Commission approved an uncontested settlement (Settlement), resolving a complaint filed on April 7, 2006 by the Public Service Commission of New York, the Pennsylvania Public Utility Commission, and the Pennsylvania Office of Consumer Advocate (collectively, State Agencies) against National Fuel Gas Supply Corporation (National Fuel).<sup>133</sup> The Settlement established new transportation and storage rates for National Fuel, established new fuel retention factors, and established terms and conditions under which National Fuel may make sales of excess gas. The settlement also set new depreciation rates for the National Fuel system and provided for refunds to National Fuel’s customers. The Settlement establishes a moratorium prohibiting the effectiveness of any NGA section 4 or section 5 rate changes on National Fuel’s system prior to December 1, 2011, and also requires National Fuel to make a section 4 rate filing effective on December 1, 2011.<sup>134</sup> Finally, the Settlement establishes that any changes to the Settlement are subject to the *Mobile-Sierra* public interest standard.<sup>135</sup> The Commission accepted the application of the public interest standard to any changes to the Settlement.<sup>136</sup>

The background to the Settlement is a complaint filed by the State Agencies, alleging that National Fuel’s rates were unjust and unreasonable, and that National Fuel did not have appropriate tariff authority to sell excess retained gas and keep the revenues from the sales. The Commission set the State Agencies’ complaint for hearing on June 7, 2006, in an order that suspended the hearing process for settlement procedures.<sup>137</sup> In setting the State Agencies’ complaint for hearing, the Commission observed that it had been over ten years since “the

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130. *Id.*

131. Opinion No. 486, *supra* note 96, at P 221 (emphasis added).

132. *Id.*

133. *Public Serv. Comm’n of New York v. National Fuel Gas Supply Corp.*, 118 F.E.R.C. ¶ 61,091 (2007) [hereinafter *National Fuel*].

134. *Id.* at P 15. The Settlement does not preclude National Fuel from filing for seasonal rates during the five-year rate moratorium, and any settling party is free to challenge any such seasonal rate filing. *National Fuel*, *supra* note 133, at P 24.

135. *United Gas Pipe Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956); *FPC v. Sierra Pac. Power Corp.*, 350 U.S. 348 (1956).

136. *National Fuel*, *supra* note 133, at P 28, n.2; Commissioners Kelly and Wellinghoff dissented to the use of the public interest standard.

137. Order Setting Complaint for Hearing, Suspending Hearing for Settlement Procedures, and Denying Motion for Summary Disposition, *Public Serv. Comm’n of New York v. National Fuel Gas Supply Corp.*, 115 F.E.R.C. ¶ 61,299 (2006) [hereinafter Hearing Order].

Commission ha[d] reviewed the justness and reasonableness of National Fuel's rates in a general [NGA] section 4 rate case."<sup>138</sup> The Commission also noted that the State Agencies, using National Fuel's Form 2 data for the years between 2000 and 2004, had "raised serious questions as to whether the rates established in the [National Fuel] 1995 settlements allow National Fuel to recover revenue substantially in excess of its costs."<sup>139</sup>

The Commission rejected National Fuel's contention that the State Agencies' arguments drawn from Form 2 data were inadequate to justify a section 5 hearing, and also rejected National Fuel's contention that a detailed cost and revenue study is required to justify an investigation into a pipeline's rates. The Commission held that Form 2 data can be used to trigger an investigation, and that the Commission has full discretion whether to conduct a section 5 hearing.<sup>140</sup> In setting the complaint for hearing, the Commission directed National Fuel to file a cost and revenue study in advance of the hearing, with all of the schedules required by the Commission's regulations for the submission of a general section 4 rate case.<sup>141</sup> The above-described settlement resulted from National Fuel's filing and from several settlement conferences.

In conjunction with filing their complaint, the State Agencies also filed a Motion for Summary Disposition to reduce National Fuel's fuel retention rates. The Commission denied the motion because there were material facts in dispute as to certain of National Fuel's fuel retention rates that needed to be investigated, and even the State Agencies had acknowledged that more information was needed to answer questions about National Fuel's actual recovery of fuel.<sup>142</sup>

*D. Panhandle Complainants v. Southwest Gas Storage Company (Docket Nos. RP07-34-000 and 001)*

On October 26, 2006, Panhandle Complainants filed a complaint under section 5 of the NGA against Southwest Gas Storage Company (Southwest Gas Storage) alleging that in a recent annual period the company had over-recovered its costs by at least \$16.9 million (or approximately 37%).<sup>143</sup> The complaint sought that the FERC order an immediate rate reduction based upon the analysis of FERC Form 2 data provided in the complaint, and also a hearing on issues raised including, among others, equity return, depreciation rate, and taxes, in order to establish the final reduced rates. In its December 21, 2006 order,<sup>144</sup> the FERC

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138. *Id.* at P 37.

139. Hearing Order, *supra* note 137, at P 37.

140. *Id.* (citing *General Motors Corp. v. FERC*, 613 F.2d 939, 944-45 (D.C. Cir 1979)).

141. Hearing Order, *supra* note 137, at P 38.

142. *Id.* at P 42.

143. Order Setting Complaint for Hearing, *Panhandle Complainants v. Southwest Gas Storage*, 117 F.E.R.C. ¶ 61,318, at P 2 (2006) [hereinafter *Panhandle*]. The Panhandle Complainants are storage customers of Southwest Gas Storage or associations that include among their members such storage customers: American Forest & Paper Association, American Iron and Steel Institute, American Public Gas Association, Anadarko Petroleum Corporation and Anadarko Energy Services Company, Citizens Utility Board of Illinois, Conoco-Phillips Company, ExxonMobil Gas & Power Marketing Company, Independent Petroleum Association of America, and Process Gas Consumers Group. *Id.* at P 1, n.1.

144. *Panhandle*, *supra* note 143. Southwest Gas Storage's January 22, 2007, request for rehearing, which asserts a number of grounds, was granted for purposes of further consideration on February 21, 2007. It re-

set the complaint for hearing and required that Southwest Gas Storage file a cost and revenue study to:

include actual data for the latest 12-month period available as of the date of this order. The filing should include all of the schedules required for the submission of a section 4 rate proceeding as set forth in section 154.312 of the Commission's regulations, except Statement P.<sup>145</sup>

The FERC denied the requested immediate rate reduction based on the data and analysis included with the complaint, but ruled that, after an opportunity for comments by the parties, if it found the cost and revenue study filed by Southwest Gas Storage pursuant to the December 21, 2006, order did not support current rates, an interim, immediately effective, rate reduction would be ordered prior to completion of the hearing procedures.<sup>146</sup>

The December 21, 2006, order also rejected Southwest Gas Storage's contention that the complaint was barred by the *Mobile-Sierra* doctrine because changes the complaint would effectively require in a 1998 settlement agreement that governed the currently effective rates could only be made under the "public interest" standard, which could not be met in the circumstances.<sup>147</sup> The FERC found that the 1998 agreement did not bar an NGA section 5 complaint, but instead provided that such a complaint would terminate the settlement. Moreover, the FERC stated that the 1998 agreement incorporated the terms of tariff form service agreements, which "do[] not contain a fixed rate, but rather include[] a Memphis clause which allows for the review of rate changes under the just and reasonable standard."<sup>148</sup>

In the December 21, 2006, order, the FERC also obviated Southwest Gas Storage contentions that the complaint must be rejected because Panhandle Complaints had no standing to bring an NGA section 5 complaint because that statute only gives a "State, municipality, State commission, or gas distributing company"<sup>149</sup> the right to file a complaint. The FERC ruled that, consistent with prior precedent, it would treat the complaint as a petition to the FERC to exercise its discretion to institute an investigation under NGA section 5, and that the FERC would exercise its discretion to do so in the circumstances.<sup>150</sup>

The December 21, 2006, order also rejected Southwest Gas Storage contentions that the complaint was "contrary to the [EPAct 2005], which was implemented to, among other things, facilitate and encourage the development of energy infrastructure, including the development of sufficient storage capacity."<sup>151</sup> The FERC found that that statute did not contravene FERC's NGA obligation to ensure just and reasonable rates, citing the facts that the complaint involved "an existing pipeline and not new construction, so there should be no

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mains pending as of the date of this committee report. Order Granting Rehearing for Further Consideration, *Panhandle Complainants v. Southwest Gas Storage Co.*, Docket No. RP07-34-000 (F.E.R.C. Feb. 21, 2007).

145. *Id.* at P Ordering.

146. *Panhandle*, *supra* note 143, at PP 2, 19-20, & 25.

147. *See generally* *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956); *FPC v. Sierra Pac. Power Co.*, 350 U.S. 348 (1956).

148. *Panhandle*, *supra* note 143, at P 23.

149. *Id.* at P 9.

150. *Panhandle*, *supra* note 143, at P 21.

151. *Id.* at P 24.

direct impact on infrastructure development”<sup>152</sup> and finding that “any indirect impact [on infrastructure development] is outweighed by the Commission’s obligation to ensure just and reasonable rates, including a just and reasonable rate of return.”<sup>153</sup>

FERC Chairman Kelliher issued a noteworthy separate statement with respect to the December 21, 2006, order.<sup>154</sup> He stated he “called this order to discuss the general approach to natural gas pipeline and storage rates reflected in this order, and steps we are taking to support complainants.”<sup>155</sup> Among other things, he “prefer[s] to rely on complaints to address gas rates outside of section 4 rate proceedings,”<sup>156</sup> noting that FERC follows this procedure as to electric rates. He noted that the burden of proof under NGA section 5 is on complainants and that he would expect complainants to turn to FERC Form 2 data to support their complaints.<sup>157</sup> Thus, he concluded, it is important that Form 2s be reliable and complete. He is concerned that respondents to complaints have argued that “Form 2 data is an insufficient basis for a section 5 complaint,”<sup>158</sup> which he stated the FERC has rejected.<sup>159</sup> He concluded stating the expectation that “we will soon take steps to strengthen Form 2, in order to improve the ability of complainants to meet their burden under section 5.”<sup>160</sup>

Southwest Gas Storage filed a cost and revenue study on February 20, 2007.<sup>161</sup> On March 5, 2007, complainants moved for rejection and otherwise protested.<sup>162</sup> They contended the study contained adjustments inconsistent with the requirements of the December 21, 2006, order and otherwise not supported. Complainants also sought interim rate reductions based upon analyses provided in the protest. As of the date of this committee report, these matters remain pending before the FERC.

The docket was assigned to Administrative Law Judge Birchman for hearing. His January 17, 2007 order provides, among other things, for a hearing to begin on August 27, 2007, and issuance of the initial decision by December 27, 2007.<sup>163</sup>

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152. *Panhandle*, *supra* note 143, at P 24.

153. *Id.*

154. Joseph T. Kelliher, Chairman, FERC, Statement at Open Commission Meeting, (Dec. 21, 2006), <http://elibrary.ferc.gov/idmws/common/opennat.asp?fileID=11213217> [hereinafter Kelliher Statement].

155. *Id.*

156. Kelliher Statement, *supra* note 154.

157. *Id.*

158. Kelliher Statement, *supra* note 154.

159. *Id.*; *See also National Fuel*, *supra* note 133, at P 28.

160. Kelliher Statement, *supra* note 154; *See also* Assessment of Information Requirements for FERC Financial Forms, 72 Fed. Reg. 8,316 (Feb. 26, 2007).

161. Cost and Revenue Study, *ExxonMobil Gas & Power Marketing Co. v. Southwest Gas Storage Co.*, Docket No. RP07-34-000 (Feb. 20, 2007).

162. Motion of the Panhandle Complainants for Interim Rate Relief and to Reject or, in the Alternative, Protest Southwest Gas Storage Company’s Cost and Revenue Study, *Panhandle Complainants v. Southwest Gas Storage Co.*, Docket No. RP07-34-000 (Mar. 5, 2007).

163. Order Adopting Procedural Schedule and Discovery Guidelines, *Panhandle Complainants v. Southwest Gas Storage Co.*, Docket No. RP07-34-000 (Jan. 17, 2007).

*E. D.C. Circuit Affirms the Policy Statement on Income Tax Allowance.*

On May 29, 2007, the D.C. Circuit issued its decision in *ExxonMobil Oil Corp. v. FERC*,<sup>164</sup> on petitions for review of orders of the FERC as to complaints against the rates of SFPP, LP, a common carrier pipeline regulated under the Interstate Commerce Act. Concurrently, the Court issued a short decision dismissing as moot the petition for review of the FERC's 2005 Tax Policy Statement,<sup>165</sup> in light of its decision affirming the Tax Policy Statement in the *ExxonMobil* decision.<sup>166</sup> *ExxonMobil* addressed several other legal issues pertaining exclusively to the regulation of oil pipelines; only the income tax issue, which broadly affects gas pipelines as well as oil pipelines and electric utilities, is discussed below.

The Court affirmed the income tax policy that the FERC adopted in the Tax Policy Statement.<sup>167</sup> The Policy Statement had been issued in response to the D.C. Circuit's prior *BP West Coast*<sup>168</sup> decision that had remanded an earlier order pertaining to SFPP, LP's rates, in which the Court had found that the FERC failed adequately to support its prior "Lakehead" tax allowance policy with respect to limited partnerships (LPs), and in which the Court had further raised questions regarding the extent to which the FERC would be justified permitting a tax allowance for pass-through entities owning pipelines.<sup>169</sup>

The Court succinctly stated its conclusion: although the FERC's orders "incorporate some of the troubling elements of the phantom tax we disallowed in *BP West Coast*, FERC has justified its new policy with reasoning sufficient to survive our review."<sup>170</sup> After summarizing the background of the income tax, including its own prior order vacating the earlier *Lakehead* tax policy and FERC's resulting Tax Policy Statement, the Court concluded that this case required a review of the conclusions and reasoning of FERC's Policy Statement.<sup>171</sup> The Court found that the key issue in reviewing that policy is whether the standard will permit pipelines to recover "all proper costs."<sup>172</sup> The Court concluded that the FERC's chosen policy of permitting an income tax allowance for LPs to the extent that the partners incur actual or potential tax liability on their distributive share of income they receive from the partnership was not "arbitrary or capricious," and was adequately explained.<sup>173</sup> The Court further found that the FERC had properly rejected three alternative tax policies and justified its rejection of those alternatives.<sup>174</sup> In particular, the Court noted the FERC's conclusion that income taxes paid by partners were "just as much a cost of acquiring and operating the assets of that entity as if the utility assets were owned by a

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164. *ExxonMobil Oil Corp. v. FERC*, 487 F.3d 945 (D.C. Cir. 2007).

165. *Tax Policy Statement*, *supra* note 125.

166. *Canadian Ass'n of Petroleum Producers v. FERC*, 487 F.3d 973 (D.C. Cir. 2007).

167. *ExxonMobil*, 487 F.3d 945.

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

169. *Id.* Pass-through entities include LPs, master limited partnerships (MLPs), limited partnerships (LPs), or limited liability companies (LLCs).

170. *ExxonMobil*, 487 F.3d at 948.

171. *Id.* at 948-51.

172. *ExxonMobil*, 487 F.3d at 948-51.

173. *Id.* at 951.

174. *ExxonMobil*, 487 F.3d at 952.

corporation.”<sup>175</sup> The Court further noted that the FERC’s determination that partners’ taxes on pipeline income could be attributed to the regulated pipeline because the taxes must be paid whether or not the partners actually receive a distribution, and hence such taxes “are ‘first-tier’ taxes that may be allocated to the regulated entity’s cost-of-service.”<sup>176</sup> The Court also found the FERC’s determination that the absence of a tax allowance would unduly lower pass-through entities’ returns below the level realized by corporations to be “not unreasonable.”<sup>177</sup> The Court concluded that it would “defer to FERC’s expert judgment about the best way to equalize after-tax returns for partnerships and corporations.”<sup>178</sup> The Court concluded its analysis of the FERC’s rationale by noting that this ratemaking issue involved reasonably-explained policy choices, which the Court would not second guess, and further noted that in assessing which costs are “proper costs” for recovery, the FERC “has broad discretion to determine which costs may be recovered through a pipeline’s rates.”<sup>179</sup>

The Court rejected arguments by the shipper petitioners that even though it might be reasonable, the FERC’s income tax policy was inconsistent with the Court’s own 2004 order in *BP West Coast*.<sup>180</sup> The prior *BP West Coast* decision hinged on the FERC’s failure to justify its then-current *Lakehead* income tax policy (treating corporate and individual unitholders differently); on remand, the Court concluded that the FERC had properly abandoned the *Lakehead* policy and adopted a new policy, justified for the reasons discussed above.<sup>181</sup> With respect to the argument that *BP West Coast* required recovery only of entity-level taxes and prohibited a “phantom tax,”<sup>182</sup> the Court found the new policy and supporting rationale to be adequate, emphasizing in particular the finding (absent in *BP West Coast*) that unitholders are liable for a tax on distributive shares of LP income even if they do not receive a cash distribution. Although the Court in *BP West Coast* had rejected the pipeline’s arguments that the FERC was required to permit a full income tax allowance for LPs, the Court notes in this decision that its prior decision did not prohibit the FERC from adopting a full pass-through policy from among different ratemaking options.<sup>183</sup>

### III. INFRASTRUCTURE

#### A. LNG Developments

##### 1. *Crown Landing, LLC*—Docket Nos. CP04-411-000 and CP04-416-000

BP affiliate, Crown Landing, LLC (Crown Landing), proposed a liquefied natural gas (LNG) terminal, to be located on the New Jersey side of the Delaware River in Logan Township, New Jersey, and was approved by the Commis-

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175. *Id.*

176. *ExxonMobil Oil Corp. v. FERC*, 487 F.3d 945, 952 (D.C. Cir. 2007).

177. *Id.* at 953.

178. *ExxonMobil*, 487 F.3d at 953.

179. *Id.*

180. *ExxonMobil*, 487 F.3d at 953-54.

181. *Id.*

182. *ExxonMobil Oil Corp. v. FERC*, 487 F.3d 945, 954 (D.C. Cir. 2007).

183. *Id.*

sion on June 20, 2006.<sup>184</sup> The proposed terminal would occupy 175 acres of land, and if completed, would have a daily base load send-out capacity of 1.2 billion cubic feet per day (Bcf/d).<sup>185</sup> In addition to facilities on the New Jersey shore, Crown Landing also requires a 2,000 foot long pier (Crown Landing Pier) extending into the Delaware River in order to allow ships carrying LNG to dock while their cargo is pumped to the terminal's storage tanks.<sup>186</sup> Without the Crown Landing Pier, there would be no way for LNG tanker ships to dock at the Crown Landing terminal.

In 2005, Delaware denied a permit for the Crown Landing Project under its Costal Zone Act, which restricts development along the state's shoreline.<sup>187</sup> Delaware's Costal Zone Industrial Control Board affirmed the denial, stating that the storage tanks at the Crown Landing facility are banned under the Delaware Costal Zone Act.<sup>188</sup> At that point, Delaware filed suit against New Jersey, asking the Supreme Court to clarify whether New Jersey had the riparian rights to develop lands along the Delaware River and the jurisdiction to regulate such developments.

The case arises from an on-going boundary dispute between Delaware and New Jersey. After multiple Supreme Court decisions, the boundary of New Jersey and Delaware along the Delaware River was established definitively by the Supreme Court holding in *New Jersey v. Delaware*.<sup>189</sup> Under this holding, the boundary within a "twelve-mile circle"<sup>190</sup> around the town of New Castle, the area in which the Crown Landing plant would be located, is the "low water line"<sup>191</sup> on the easterly, or New Jersey, side of the Delaware River. While neither state disputes the boundary, the present dispute surrounds regulatory jurisdiction for riparian improvements that extend out from the New Jersey shore into the Delaware River. Delaware contends that it has jurisdiction to regulate the construction of the Crown Landing Pier as it extends past the "low water mark," which constitutes the boundary between New Jersey and Delaware and into the sovereign territory of Delaware.<sup>192</sup> Conversely, New Jersey argues that it has the jurisdiction to regulate the LNG terminal project as a whole because of its right to convey riparian lands along the New Jersey side of the Delaware River.<sup>193</sup> New Jersey further contends that, historically, "Delaware made few, if any, attempts to regulate" riparian improvements on the New Jersey shore, and thus, New Jersey had the right to issue various grants and leases of riparian lands and

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184. *Crown Landing, LLC* 115 F.E.R.C. ¶ 61, 348 (2006).

185. *Id.* at PP 3, 5.

186. 115 F.E.R.C. ¶ 61,348, at PP 3, 5.

187. DEL. CODE ANN. tit. 7, § 7001 (2007) (controlling "the location, extent and type of industrial development in Delaware's coastal areas" and further requiring that all control of industrial development in the coastal zone of Delaware obtain a permit from the Delaware Department of Natural Resources and Environmental Control).

188. Report of the Special Master at 150-58, *New Jersey v. Delaware*, No. 134 (U.S. Apr. 12, 2007) [hereinafter Special Master Report].

189. *New Jersey v. Delaware*, 295 U.S. 694 (1935) (interpreting the Compact of 1905, a boundary agreement entered into by both New Jersey and Delaware).

190. *Id.* at 694.

191. *New Jersey*, 295 U.S. at 695-98.

192. Special Master Report, *supra* note 188, at 18.

193. *Id.*

regulate related improvements along its own shore.<sup>194</sup> Due to this historical pattern of regulation, New Jersey further contends that it was the states' intention under the Compact for New Jersey to have exclusive jurisdiction to regulate riparian development along the eastern shore.<sup>195</sup> Delaware argued that it has enacted a variety of statutes designed to protect Delaware's coastal waters and wetlands along the Delaware River, and that due to the boundary established by *New Jersey v. Delaware*, it has full jurisdiction over the Delaware River.<sup>196</sup>

While the Report of the Special Master, filed April 12, 2007 (Report), found that New Jersey had the right to regulate riparian improvements along the eastern shore of the Delaware River, the Special Master found that New Jersey had a right "to reasonable access to and use of the adjacent water, subject to appropriate regulation."<sup>197</sup> The Report found that both states have overlapping jurisdiction to regulate riparian developments under the language of the Compact.<sup>198</sup> Even though New Jersey retained the right to regulate riparian projects along its shoreline, Delaware was entitled to regulate any improvements extending onto its territory as the sovereign owner of the land beyond the low water mark.<sup>199</sup> Delaware's position is that under this finding, it would be appropriate for it to prohibit the proposed Crown Landing Pier under the Delaware Coastal Zone Act.

The Supreme Court is expected to schedule a hearing for this case sometime in 2008. While the Report was not favorable to Crown Landing's interests, BP spokesman Tom Mueller has been quoted as characterizing the report "an interim step" and stating that BP remains "optimistic" that the Crown Landing Terminal will ultimately be completed.<sup>200</sup>

## 2. US LNG Terminal Authorizations (July 2006 through June 2007)

### a. Freeport LNG Development, L.P.—Docket No. CP05-361-000

The Freeport LNG Development, LP (Freeport LNG) liquefied natural gas (LNG) terminal expansion of existing facilities located on Quintana Island, Brazoria County, Texas, was approved by the Commission on September 26, 2006, under section 3 of the NGA.<sup>201</sup> The approved expansion constitutes Phase II of the original Freeport LNG Project, which was authorized on June 18, 2004.<sup>202</sup> Once completed, the expansion will increase the terminal send-out capacity from 1.5 Bcf/d to 4.0 Bcf/d.<sup>203</sup>

### b. *Gulf LNG Energy, LLC*—Docket Nos. CP06-12-000, CP06-13-

194. Special Master Report, *supra* note 188, at 18.

195. *Id.* at 19.

196. Special Master Report, *supra* note 188, at 19.

197. *Id.* at 49.

198. Special Master Report, *supra* note 188, at 84.

199. *Id.* at 85.

200. *New Jersey loses round in land-use tussle with Delaware central to Crown Landing LNG project*, INSIDE F.E.R.C., Apr. 23, 2007, at 15.

201. *Freeport LNG Development, LP*, 116 F.E.R.C. ¶ 61,290, at P 2 (2006).

202. *Freeport LNG Development, LP*, 107 F.E.R.C. ¶ 61,278 (2004).

203. 116 F.E.R.C. ¶ 61,290, at P 1.



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The Gulf LNG Energy, LLC (Gulf LNG) LNG terminal (and associated pipeline project), to be located in Jackson County, Mississippi, was approved by the FERC under section 3 of the NGA on February 16, 2007.<sup>204</sup> The Commission also authorized Gulf LNG's concurrent application under section 7(c) of the NGA to construct and operate an 5.02 mile-long, 36-inch diameter pipeline from the proposed LNG terminal to interconnections with two interstate pipelines and a gas processing plant.<sup>205</sup> Once completed, the project, known as the LNG Clean Energy Project, will have a peak deliverability of 1.5 Bcf/d.<sup>206</sup>

c. *Bayou Casotte Energy LLC*,— Docket No. CP05-420-000

The Bayou Casotte Energy, LLP (Bayou Casotte) LNG terminal, to be located in Jackson County, Mississippi, was approved under section 3 of the NGA by the FERC on February 16, 2007.<sup>207</sup> Once completed, the terminal will be able to deliver a baseload volume of 1.3 Bcf/d of LNG to the interstate pipeline system, and a peak volume of 1.6 Bcf/d.<sup>208</sup> Bayou Casotte is a wholly-owned subsidiary of Chevron U.S.A., Inc. (Chevron), and the Bayou Casotte LNG terminal would be used by Chevron for the importation of its LNG supplies from various locations around the world to U.S. markets.<sup>209</sup> Bayou Casotte will deliver regasified LNG into the interstate pipeline system through interconnections located on Chevron-controlled property.<sup>210</sup> Bayou Casotte anticipates interconnecting with the following five pipelines from a 36-inch diameter sendout line: Gulfstream Natural Gas System, LLC; Chandeleur Pipe Line Company (two separate pipelines); Gulf South Pipeline Company, LP; and Destin Pipeline Company, LLC.<sup>211</sup> The sendout pipeline would begin on the terminal site and extend approximately 1.5 miles along a route immediately adjacent to the southern boundary of the Chevron refinery to a terminus with an interconnect with Gulfstream.<sup>212</sup> The Commission granted Bayou Casotte's request to operate the pipeline facilities on a proprietary basis without filing tariffs or rate schedules with the Commission.<sup>213</sup>

B. *Pipeline Project Developments*

1. Certification of Northeast (NE)-07 Project

On December 21, 2006, the Commission issued certificates of public convenience and necessity for several related projects, collectively referred to as the

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204. *Gulf LNG Energy, LLC*, 118 F.E.R.C. ¶ 61,128 (2007).

205. *Id.* at P 88.

206. 118 F.E.R.C. ¶ 61,128, at P 1.

207. *Bayou Casotte Energy, LLC*, 118 F.E.R.C. ¶ 61,129 (2007).

208. *Id.* at P 3.

209. 118 F.E.R.C. ¶ 61,129, at P 2.

210. *Id.* at P 4.

211. 118 F.E.R.C. ¶ 61,129, at P 4, n.2.

212. *Id.*

213. *Bayou Casotte Energy, LLC*, 118 F.E.R.C. ¶ 61,129, at P 4 (2007).

Northeast (NE)-07 Project.<sup>214</sup> The Order approved (i) Millennium Pipeline Company, LLC's (Millennium) proposal to construct and operate facilities extending from Corning, New York, to Ramapo, New York, including, among other things, 181.7 miles of 30-inch diameter pipeline and a 15,002-horsepower compressor station; (ii) Columbia Gas Transmission Corporation's (Columbia) abandonment of certain Line A-5 facilities to Millennium and lease of capacity on those facilities so that it could continue service to its Line A-5 customers; (iii) Empire Pipeline, Inc.'s (EPI) construction and operation of a 78-mile, 24-inch diameter pipeline from Victor, New York to an interconnection with Millennium near Corning, New York; (iv) Algonquin Gas Transmission, LLC's (Algonquin) replacement of 4.8 miles of 26-inch diameter pipeline with 42-inch diameter pipeline and construction and operation of new and/or expanded compression facilities at Oxford, Connecticut, the towns of Southeast, New York, Stony Point, New York, and Hanover, New Jersey; and (v) Iroquois Gas Transmission System, LP's proposed reduction of the size of a previously certified, but not yet built, compressor unit in Brookfield, Connecticut, from 10,000 to 7,700 horsepower and proposed installation of gas cooling facilities at the Brookfield compressor station and at an existing compressor station in Dover, New York.<sup>215</sup> These projects were evaluated and approved in a single order because each was necessary to meet the customers' demand for firm capacity over the entire length of the combined projects.

In 2002, the FERC had issued an order authorizing Millennium to construct and operate over 400 miles of pipeline from the Canadian border in Lake Erie across the Hudson River and into Mount Vernon, New York. However, that configuration of the Millennium project was never constructed because the New York Department of State found the route to be inconsistent with New York's Coastal Management Program implemented under the federal Coastal Zone Management Act (CZMA), a decision which was upheld by the D.C. District Court.<sup>216</sup>

The Northeast (NE)-07 Project includes a scaled down version of the Millennium project, which does not involve crossings of Lake Erie and the Hudson River and which relies on the addition of new firm transportation capacity by EPI, Algonquin, and Iroquois. The Northeast (NE)-07 Project is supported by long-term precedent agreements entered into between the pipeline sponsors and Consolidated Edison Company of New York, Inc. (ConEd), KeySpan Energy Delivery Long Island, Columbia, and Central Hudson Gas & Electric Corporation (Central Hudson).<sup>217</sup>

The Commission (i) approved Millennium's proposed recourse rates; (ii) authorized Millennium to record a regulatory asset in connection with its leveraged negotiated rate agreements, and (iii) found that Millennium had adequately addressed the risk of construction cost overruns in its precedent agreements, and (iv) approved Millennium's lease agreements with Columbia.<sup>218</sup> The Commis-

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214. *Millennium Pipeline Company, LLC*, 117 F.E.R.C. ¶ 61,319 (2006), *order on reh'g*, 119 F.E.R.C. ¶ 61,173 (2007).

215. *Id.* at P 2.

216. *Millennium Pipeline Co. v. Gutierrez*, 424 F. Supp. 2d 168 (D.D.C. 2006).

217. 117 F.E.R.C. ¶ 61,319, at P 60.

218. *Id.* at P Ordering A-JJ.

sion approved the Millennium, EPI, Algonquin, and Iroquois projects but, among other things, (i) rejected EPI's proposal to base its recourse rates on the written up value of certain acquired facilities rather than their net book value; (ii) ordered Algonquin to ensure that expansion fuel use costs were not charged to its existing shippers, and required Algonquin to account for the actual fuel use and LAUF associated with the proposal in its annual fuel tracker filing; (iii) barred Columbia from beginning recovery of lease payments recorded in Account 858 via a Transportation Cost Rate Adjustment (TCRA) filing until after it had removed the costs of the Line A-5 facilities from its base rates via a section 4 filing; and (iv) refused to allow EPI to include a 4% inflation adjustment in various factors of its cost of service estimate.<sup>219</sup>

## 2. Certification of REX-West Project

On April 19, 2007, the Commission issued an order certifying the Rockies Express Pipeline, LLC's (Rockies Express) REX-West expansion project and related projects proposed by TransColorado Gas Transmission Company (TransColorado) and Questar Overthrust Pipeline Company (Overthrust).<sup>220</sup> Collectively, these three projects consist of 796 miles of new pipeline, 237,320 horsepower of compression, meter stations, and other facilities in Colorado, Wyoming, Nebraska, Missouri, and New Mexico.<sup>221</sup>

The Commission approved Overthrust's request for authority to abandon by lease to Rockies Express 625,000 Dth/d of firm transportation capacity on both its existing facilities as well as on its proposed facilities.<sup>222</sup> However, the Commission required Overthrust to recalculate its proposed rates and required the force majeure provision (Article V) of the lease agreement to be modified to exclude "routine maintenance."<sup>223</sup> In addition, the Commission reaffirmed its rejection of a Rockies Express tariff provision that would have allowed the pipeline to blend gas to the extent operationally feasible, to accommodate the gas of those original shippers who had firm service agreements in place when service commenced, on a "first-through-the-meter" basis.<sup>224</sup> The Commission held that the tariff provision's reliance on the date a shipper contracted for service did not justify accepting original shippers' gas that did not meet the gas quality specifications of Rockies Express tariff before it accepted such gas from future shippers.<sup>225</sup> The Commission determined that providing a different quality of firm service to original shippers at the potential expense of future shippers was not justified.<sup>226</sup>

The Commission required that the capacity lease be treated as an operating lease for accounting purposes and that monthly receipts be recorded in Account 489.2, where revenues are treated as a credit to the company's cost of service.<sup>227</sup>

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219. 117 F.E.R.C. ¶ 61,319, at P Ordering A-JJ.

220. *Rockies Express Pipeline, LLC*, 119 F.E.R.C. ¶ 61,069 (2006).

221. *Id.* at P 5.

222. 119 F.E.R.C. ¶ 61,069, at P 40.

223. *Id.* at PP 42-43.

224. 119 F.E.R.C. ¶ 61,069, at P 11.

225. *Id.* at P 51.

226. *Rockies Express Pipeline, LLC*, 119 F.E.R.C. ¶ 61,069, at P 56 (2006).

227. *Id.* at P 66.

The Commission also found that the proposed initial interruptible rate was inappropriate because the Information Technology (IT) service would only be provided on the expanded integrated system.<sup>228</sup> The Commission required Overthrust to use its existing system-wide IT rate, and to maintain records that identify the costs associated with its expansion facilities.<sup>229</sup> Finally, while the Commission agreed that it was appropriate to establish a mechanism to recover and track fuel use on the system, it rejected the proposal because it appeared to apply to all shippers and not just the incremental shippers using the expansion capacity.<sup>230</sup> Overthrust had similarly proposed a change to its tariff to reflect a limit of two percent on the amount of carbon dioxide that can be present in the gas received by Overthrust. The Commission found that Overthrust should seek to make these changes in a limited section 4 proceeding.<sup>231</sup>

### C. Storage Developments

#### 1. Expanded Opportunities for Market-Based Rate Authority for Natural Gas Storage Facilities as a Tool to Develop Additional Storage Capacity

Section 312 of the Energy Policy Act of 2005 (EPAAct 2005) added a new section 4(f) to the Natural Gas Act (NGA) that permitted the Commission to grant market-based rate authorization to natural gas storage service providers, even without a demonstration of a lack of market power, upon a showing of certain conditions, including that market-based rates are in the public interest and the customers in the service area are adequately protected.<sup>232</sup> This legislation, coupled with the Commission's continuing efforts to foster the development of new natural gas storage facilities, prompted the Commission to issue Order No. 678,<sup>233</sup> establishing regulations that reformed the existing storage pricing policies. Order No. 678 reflects the Commission's dual goals of encouraging the development of additional storage capacity, thereby mitigating natural gas price volatility, while protecting consumers from the exercise of market power.<sup>234</sup> Order No. 678 developed two approaches that enhanced the Commission's ability to authorize market-based rates for certain natural gas storage service providers. Since the issuance of Order No. 678, the Commission has used its new authority to authorize market-based rates for Northern Natural Gas Company (Northern Natural).<sup>235</sup>

##### a. EPAAct 2005 Framework for Commission's Final Rule

Section 312 of EPAAct 2005, enacted on August 8, 2005, added a new section 4(f) to the NGA, permitting the Commission to "authorize a natural gas

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228. 119 F.E.R.C. ¶ 61,069, at P 67.

229. *Id.*

230. 119 F.E.R.C. ¶ 61,069, at P 68.

231. *Id.*

232. Energy Policy Act, *supra* note 62, § 312.

233. Order No. 678, *Rate Regulation of Certain Natural Gas Storage Facilities*, F.E.R.C. STATS. & REGS. ¶ 31,220 (2006), 71 Fed. Reg. 36,612 (2006) (to be codified at 18 C.F.R. pt. 284) [hereinafter Order No. 678].

234. *Id.* at P 134.

235. *Northern Natural Gas Co.*, 117 F.E.R.C. ¶ 61,191 (2006), *denying reh'g*, 119 F.E.R.C. ¶ 61,072 (2007).

company . . . to provide storage and storage-related services at market-based rates for new storage capacity related to a specific facility placed in service after [August 8, 2005], notwithstanding the fact that the company is unable to demonstrate that the company lacks market power.”<sup>236</sup> In order to exercise that authority, the Commission must determine that: (1) market-based rates are in the public interest and necessary to encourage the construction of the storage capacity in the area needing storage services; and (2) customers are adequately protected.<sup>237</sup> If the Commission authorizes a natural gas company to charge market-based rates pursuant to section 4(f), the Commission must periodically review whether the market-based rate is just, reasonable, and not unduly discriminatory or preferential.<sup>238</sup>

#### b. Final Rule

On June 19, 2006, the Commission issued Order No. 678,<sup>239</sup> its Final Rule amending its regulations to establish the criteria for natural gas storage services to obtain market-based rates. Order No. 678 became effective on July 27, 2006.<sup>240</sup> The Final Rule provides a two-pronged approach to reforming the existing storage pricing policy.<sup>241</sup>

##### 1) Expanded Product Market Definition

The Final Rule modified the Commission’s market power analysis by adopting a more expansive definition of the relevant product market for gas storage, explicitly including what the Commission considered to be substitutes for gas storage services, including pipeline capacity, local production, and liquefied natural gas (LNG) supplies.<sup>242</sup> The Commission will evaluate potential substitutes in the context of individual applications for market-based rates, as storage applicants are permitted to include non-storage products and services in calculating their market concentration and market share.<sup>243</sup> The burden is on the applicant to demonstrate that the non-storage product or service is an adequate substitute.<sup>244</sup>

The Commission reformed its market power test to more accurately reflect the competitive conditions in the market for gas storage services, as buyers and sellers have a greater number of alternatives from which to choose to obtain and deliver gas supplies.<sup>245</sup> A good substitute is defined as one that is “available soon enough, has a price that is low enough, and has a quality high enough to permit customers to substitute the alternative for the applicant’s service.”<sup>246</sup>

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236. Energy Policy Act, *supra* note 62, § 312.

237. *Id.*

238. Energy Policy Act, *supra* note 62, § 312.

239. Order No. 678, *supra* note 233.

240. *Id.*

241. Order No. 678, *supra* note 233, at PP 4-5.

242. *Id.* at P 25.

243. Order No. 678, *supra* note 233, at P 27.

244. *Id.*

245. Order No. 678, *supra* note 233, at PP 11, 25-26.

246. *Id.* at P 47.

The Commission declined to impose a generic requirement on storage providers granted market-based rates on the basis of a market power analysis and declined the requirement to file an updated market-power analysis every five years.<sup>247</sup> Rather, the Commission asserted its belief that the existing posting and reporting requirements (such as change in status reports) and its ongoing market monitoring programs generally provide it with sufficient information to determine whether storage markets remain competitive, and the Commission observed that it has the ability to take appropriate action if market power issues arise.<sup>248</sup> The Commission concluded in Order No. 678 that storage providers with a market share of 10% or less generally would be exempt from such a reporting requirement.<sup>249</sup> For storage providers with a market share greater than 10%, the Commission intends to consider in individual cases whether the facts and circumstances presented require additional reporting.<sup>250</sup>

## 2) Implementation of Section 312

Order No. 678 also adopts regulations that implement section 312 of EPAct 2005, by permitting the Commission to authorize market-based rates for natural gas projects, notwithstanding the fact that the applicant fails to demonstrate a lack of market power, and in those circumstances when: (1) market-based rates are in the public interest; (2) market-based rates are necessary to encourage the construction of storage capacity; (3) the area in which the storage project is proposed needs storage services; and (4) customers are adequately protected.<sup>251</sup> The regulations “would enable storage providers to seek market-based rates for service associated with capacity related to any ‘specific facility’ requiring certification placed in service after the date of [EPAct 2005], be it a new storage cavern or a facility which expands capacity at an existing cavern or reservoir.”<sup>252</sup> However, the storage provider must satisfy the other requirements of NGA section 4(f) in order to receive authorization.<sup>253</sup>

“In determining whether market-based rates for a particular project are in the public interest, the Commission will consider, among other things, the risk of the project,” whether the applicant is a new independent storage provider or an existing pipeline in the relevant market, and “the investment required to fund it.”<sup>254</sup> An applicant can demonstrate the need for storage services in the area by including “evidence of a general lack of storage in the area or that existing storage capacity is fully utilized, pipeline constraints leading into the area, projected increased demand for natural gas in the area to be served, customer interest, high natural gas prices and/or volatility. . . .”<sup>255</sup>

In addition, the Commission discussed various ways in which an applicant for market-based rates could provide adequate customer protection, such as: (1)

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247. Order No. 678, *supra* note 233, at P 90.

248. *Id.*

249. Order No. 678, *supra* note 233, at P 91.

250. *Id.*

251. Order No. 678, *supra* note 233, at P 102.

252. *Id.* at P 115.

253. Order No. 678, *supra* note 233, at P 115.

254. *Id.* at P 126.

255. Order No. 678, *supra* note 233, at P 131.

showing that the applicant conducted a “fair and transparent open season,” and complied with the non-discriminatory access requirements of the Commission’s regulations;<sup>256</sup> (2) “ensuring that existing customers are not subject to additional costs, risks, or degradation of service resulting from new services provided under Section 4(f)”;<sup>257</sup> (3) providing service under an “open-access tariff stating the terms and conditions of service offered”;<sup>258</sup> (4) submitting a proposal that adequately prevents withholding;<sup>259</sup> and (5) establishing some form of a reserve price for use in an open season.<sup>260</sup>

### 3) Order on Rehearing

On November 16, 2006, the Commission issued an order denying rehearing of Order No. 678 and providing clarification in some areas.<sup>261</sup> The Commission’s actions are as follows:

- Rejecting arguments on rehearing that the Commission should not apply the expanded product market definition to existing storage facilities;<sup>262</sup>
- Refusing to foreclose or mandate any particular method for determining the suitability of a product as a substitute for natural gas storage service;<sup>263</sup>
- Refusing to adopt a generic periodic filing requirement for all storage providers with market-based rates than have a 10% or greater market share, as the determination on whether to impose a periodic filing requirement for these storage providers should be made on a case-by-case basis (such as when the record in an individual proceeding indicates that the existing reporting requirements and change of status filing requirement will not provide sufficient information concerning the relevant storage market);<sup>264</sup>
- Affirming its decision to define the term “facility” in section 312 broadly to include expansions of existing facilities;<sup>265</sup>
- Clarifying that, in order to demonstrate that market-based rate authority will not adversely impact existing customers, an applicant is required to: “(1) ensure that existing customers will not be subject to additional costs, risks or degradation of service; (2) separately account for the costs, services, and commitments provided under Section 4(f) authorizations; and (3)

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256. *Id.* at P 154.

257. Order No. 678, *supra* note 233, at P 156.

258. *Id.* at P 158.

259. Order No. 678, *supra* note 233, at P 163.

260. *Id.*

261. Order No. 678-A, *Rate Regulation of Certain Natural Gas Storage Facilities*, 117 F.E.R.C. ¶ 61,190 (2007) [hereinafter Order No. 678-A].

262. *Id.* at P 6.

263. Order No. 678-A, *supra* note 261, at P 11.

264. *Id.* at P 12.

265. Order No. 678-A, *supra* note 261, at P 23.

provide non-discriminatory terms and conditions of service under an open-access tariff<sup>266</sup>, and

- Continuing to believe that the ongoing review of storage operations adopted in Order No. 678 will provide a greater degree of customer protection than would periodic filings concerning the adequacy of an individual applicant's customer protections put in place as a condition of market-based rate authority.<sup>267</sup>

## 2. Requested Authorization of Market-Based Rates for Storage Facilities

To date, two applicants have sought market-based rate authority pursuant to Order No. 678.

### a. Northern Natural Gas Company

On July 17, 2006, Northern Natural Gas Company (Northern Natural) submitted a petition for a declaratory order finding that it would be authorized to charge market-based rates to the initial shippers that submitted winning bids and signed precedent agreements for Firm Deferred Delivery (FDD) service resulting from a planning expansion (2008 FDD Expansion) of Northern Natural's storage field.<sup>268</sup> On November 16, 2006, the Commission granted Northern Natural's petition.<sup>269</sup> The Northern Natural Order determined that market-based rates were necessary for the 2008 FDD Expansion after Northern Natural conducted an open season to determine customer interest.<sup>270</sup> In addition, Northern Natural argued that the risk associated with the development of an aquifer storage facility warrants a higher rate of return than traditional pipeline investment. Thus, by using market-based rates, Northern Natural stated that it would be able to offer prospective customers rate certainty, while accepting the significant risk that accompanies operation of the facility.<sup>271</sup> Further, Northern Natural asserted that it would be able to protect existing Rate Schedule FDD customers from the potential risk associated with the project.<sup>272</sup>

The Commission concluded that Northern Natural met the criteria necessary to negotiate market-based rates for the shippers that submitted winning bids in an open season and that signed precedent agreements for service.<sup>273</sup> As an initial matter, the Commission concluded that Northern Natural demonstrated that the 2008 FDD Expansion related to specific facilities to be placed in service after August 8, 2005, as the ultimate design of the facilities necessary for the project would be completed after the receipt of the final reservoir analysis that would determine the cycle capability of the field.<sup>274</sup>

266. *Id.* at P 24.

267. Order No. 678-A, *supra* note 261, at P 27.

268. Petition for Declaratory Order, *Northern Natural Gas Co.*, Docket No. RP06-437-000 (F.E.R.C. July 17, 2006).

269. *Northern Natural Gas Co.*, 117 F.E.R.C. ¶ 61,191 (2006), *denying reh'g*, 119 F.E.R.C. ¶ 61,072 (2007).

270. *Id.* at P 1.

271. 117 F.E.R.C. ¶ 61,191, at P 4.

272. *Id.*

273. 117 F.E.R.C. ¶ 61,191, at P 9.

274. *Id.* at P 12.



The Commission also concluded that market-based rates in this instance “are in the public interest and necessary to encourage the construction of the storage capacity in the area needing storage service.”<sup>275</sup> The Commission indicated that market-based rates would provide Northern Natural with the possibility of optimizing the efficient use of its existing infrastructure, for the following reasons:

- Additional storage is clearly necessary in this area;<sup>276</sup>
- Northern Natural identified sufficient investment risks in proceeding with the project without market-based rates (e.g., “evidence of significant engineering uncertainties, including the potential need for treatment facilities, the possible need to construct additional wells, and the difficulty in determining the volume and price of base gas”), and indicated that the expansion project would not proceed absent market-based rates;<sup>277</sup> and
- The filing does not fit traditional cost-based rate applications, since Northern Natural assumed all the risks of subsequent cost increases. Using traditional cost-based rates, Northern Natural’s customers would be subject to potential rate increases through NGA section 4 filings if Northern Natural’s cost projections were in error.<sup>278</sup>

The Commission also found that Northern Natural adequately protects both its expansion and existing customers, for the following reasons:

- “Northern Natural held an open season in which it included all of the capacity that was estimated to be available in the storage project”,<sup>279</sup>
- In the event that capacity exceeds the projected amount, Northern Natural committed to giving any additional capacity to the highest bidder that did not receive capacity under its open season auction,<sup>280</sup>
- “Northern Natural conducted a transparent auction where it awarded capacity to the shippers bidding the highest net present value, including rate and contract term. Rates resulting from such an auction reflect competitive prices, not the exercise of market power”,<sup>281</sup>
- Northern Natural established a “maximum ceiling price of \$1.50 and a ceiling term of 20 years, such that any bids at or

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275. *Northern Natural Gas Co.*, 117 F.E.R.C. ¶ 61,191, at P 13 (2006).

276. *Id.* at P 15.

277. 117 F.E.R.C. ¶ 61,191, at P 16.

278. *Id.* at P 17.

279. 117 F.E.R.C. ¶ 61,191, at P 20.

280. *Id.*

281. *Northern Natural Gas Co.*, 117 F.E.R.C. ¶ 61,191, at P 20 (2006).

above the ceiling levels would be considered as if they were at the ceiling levels”;<sup>282</sup> and

- “Northern Natural met the other criteria established in Order No. 678 because it offered the proposed service pursuant to its General Terms and Conditions of Service.”<sup>283</sup>

The Commission also concluded that Northern Natural’s proposal adequately protects existing cost-based rate customers, as: (1) “[t]he rates of existing customers are unaffected by the instant proposal”; and (2) “Northern Natural will separately account for all costs and revenues associated with facilities used to provide the market-based services.”<sup>284</sup> The Commission indicated that maintaining separate records will help enable Northern Natural to ensure that existing customers will not subsidize the costs of the expansion.<sup>285</sup>

Commissioner Kelly dissented from this order, concluding that Northern Natural failed to meet the requirements of Order No. 678 to prove that market-based rates are in the public interest and provide adequate customer protection. Commissioner Kelly stated that the open season process in this instance proves that market-based rates are not needed for the storage project, providing as follows:

[W]e can expect that Northern [Natural] designed the floor that it imposed on open season bidders to be somewhere above its current estimate of what it will cost to perform the expansion. In other words, this floor can be expected to be no less than an initial cost-based rate for purposes of determining customer interest through precedent agreements. Bidders nevertheless requested more storage capacity than was offered and most of their bids were in fact above the floor. This indicates not only strong demand at a price level no less than the initial cost-based rate level would have been, but at even higher price levels as well. In the face of this, there does not appear to be strong evidence that customer objections would have prevented the use of a traditional cost-based rate.<sup>286</sup>

Commissioner Kelly also provided at least two reasons that Northern Natural failed to support its claim of adequate customer protection. First, while Northern Natural claimed that expansion customers were protected because the proposal gives them rate certainty over a twenty-year period thereby shifting the risk of cost increases to Northern Natural, there appeared to be two contractual provisions that provide Northern Natural the ability to back out of the expansion for economic reasons.<sup>287</sup> Second, the open season failed to provide the needed protection because the proposal used twenty-year term caps, which were too long (and thus failed to address term-based market power concerns raised in prior court cases reviewing the Tennessee Gas Pipeline Company proposal to increase its term cap to 20 years)<sup>288</sup> and there was no reserve price in the open season.<sup>289</sup>

282. *Id.*

283. 117 F.E.R.C. ¶ 61,191, at P 20.

284. *Id.* at P 21.

285. 117 F.E.R.C. ¶ 61,191, at P 21.

286. *Id.* at 61,949 (Kelley, G., dissenting).

287. *Northern Natural Gas Co.*, 117 F.E.R.C. ¶ 61,191, at 61, 950 (2006) (Kelley, G., dissenting).

288. *Process Gas Consumers Group v. FERC*, 292 F.3d 831 (D.C. Cir. 2002) (finding that the Commission had not adequately supported its decision to approve a pipeline proposal to increase its term cap to twenty

Commissioner Kelley added that “[n]either are the rate-based market power concerns that underlie the entire NGA, including new Section 4(f), addressed by the proposed term cap or the proposed non-cost-based bid caps to which the customers are bound but to which the provider is never truly bound . . . .”<sup>290</sup>

b. Enstor Houston Hub Storage and Transportation, L.P.

Other than Northern Natural, there has been only one other instance thus far in which an applicant has relied upon Order No. 678 in requesting market-based rates for storage services. Enstor Houston Hub Storage and Transportation, L.P. (Houston Hub) submitted an abbreviated application, on May 27, 2007, for: (1) a certificate of public convenience and necessity authorizing it to construct, own, operate, and maintain a salt dome natural gas storage project; (2) a blanket certificate authorizing it to provide open-access firm and interruptible interstate natural gas storage and hub services on behalf of others with pregranted abandonment for those services; and (3) authority to provide the proposed interstate storage services and hub services at market-based rates.<sup>291</sup> Houston Hub requested market-based rate authorization pursuant to Order No. 678 and the Commission’s traditional policy concerning market-based rates for natural gas pipelines.<sup>292</sup>

Houston Hub asserted that it “plainly lacks market power”<sup>293</sup> under either the conventional approach of the Alternative Rate Policy Statement and the revised approach of Order No. 678. Houston Hub asserted that it does not possess market power for its storage services in the relevant geographic markets that it can serve (which are the Mid-Continent region from Southeast Texas to Kansas and the Gulf Coast region from Texas to Alabama) and that, based on the number of existing storage services, sufficient alternatives to conventional storage, and the number of proposed storage projects, entry in the markets can occur with relative ease.<sup>294</sup> Houston Hub added that because it satisfied the Commission’s requirements for market-based rate authorization under the historic policy, it would stand to reason it would satisfy the more liberal approach in Order No. 678 (with the expanded definition of the relevant product market). Accordingly, Houston Hub submitted that additional analysis under Order No. 678 was not necessary and market-based rates for Houston Hub’s proposed firm and interruptible storage and hub services is justified.<sup>295</sup> This application is currently pending before the Commission.

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years); *Process Gas Consumers Group v. FERC*, 177 F.3d 995 (D.C. Cir. 1999) (concluding that the FERC reevaluated the issue and satisfactorily explained its ultimate decision to eliminate the bid cap altogether).

289. 117 F.E.R.C. ¶ 61,191, at 61,951 (Kelley, G., dissenting).

290. *Id.*

291. Application for Certificate of Public Convenience and Necessity, *Enstor Houston Hub Storage and Transportation, L.P.*, Docket Nos. CP07-390-000, CP07-391-000, CP07-392-000 (May 24, 2007).

292. *Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines*, 74 F.E.R.C. ¶ 61,076 (1996), *reh’g denied*, 75 F.E.R.C. ¶ 61,076 (1996). Other recent applicants relied on this Alternative Rate Policy Statement to demonstrate that it lacks significant market power instead of Order No. 678.

293. *Supra* note 291, at 23.

294. *Id.*

295. *Supra* note 291, at 24.

*D. Order No. 686, the Blanket Certificate Rulemaking*

The Commission has offered a blanket certificate program since 1982 to allow certain enumerated activities that are subject to section 7 abandonment or certificate requirements to proceed without first obtaining a separate, custom-drafted order from the Commission.<sup>296</sup> Instead, a single blanket certificate would authorize a number of construction projects subject to a per-project and annual dollar limit.

In 2005, the Interstate Natural Gas Association of America (INGAA) and Natural Gas Supply Association (NGSA), respectively a pipeline and a producer industry trade association, petitioned the Commission to increase the dollar limits and advocated that the limits escalate with the Handy-Whitman Index rather than the currently used implicit GDP deflator factor.<sup>297</sup>

On October 19, 2006, the Commission issued Order No. 686, which amended the blanket certificate regulations, and all pipelines' blanket certificates.<sup>298</sup> Order No. 686 expands the timeframes for landowner notification under the automatic authorization provision from thirty days to forty-five days, and from forty-five days to sixty days for projects eligible for the prior notice procedures.<sup>299</sup> The rule broadened the types of natural gas projects permitted under blanket certificate authority to include certain mainline, storage, and liquefied natural gas (LNG) and synthetic gas pipeline facilities.<sup>300</sup> The rule also raises the cost limits that apply to eligible blanket certificate projects from the current \$8.2 million to \$9.6 million for automatic authorizations and from \$22.7 million to \$27.4 million for prior-notice projects.<sup>301</sup> In addition, Order No. 686 clarified that a company is not necessarily engaged in an unduly discriminatory practice if it charges different customers different rates for the same service when customers commit to service on different dates.<sup>302</sup> The revised blanket certificate regulations became effective on January 2, 2007.

On June 22, 2007, the Commission issued Order No. 686-A<sup>303</sup> in response to a number of requests for rehearing or reconsideration. Order No. 686-A expanded the blanket certificate coverage to permit companies to make modifica-

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296. Order No. 234, *Interstate Pipeline Certificates for Routine Transactions*, [Regs. Preambles 1982-1985] F.E.R.C. STATS. & REGS. ¶ 30,368 (1982), 47 Fed. Reg. 24,254 (1982) (to be codified at 18 C.F.R. pts. 157, 284, 375); Order No. 234-A, *Interstate Pipeline Certificates for Routine Transactions*, [Regs. Preambles 1982-1985] F.E.R.C. STATS. & REGS. ¶ 30,389 (1982), 47 Fed. Reg. 38,871 (1982) (to be codified at 18 C.F.R. pt. 157).

297. Joseph T. Kelliher, Chairman, FERC, Statement at Open Commission Meeting Revisions to the Blanket Certificate Regulations and Clarification Regarding Rates, 2 (June 15, 2006), <http://www.ferc.gov/news/statements-speeches/kelliher/2006/06-15-06-kelliher-C-3.pdf>.

298. Order No. 686, *Revisions to the Blanket Certificate Regulations and Clarification Regarding Rates*, F.E.R.C. STATS. & REGS. ¶ 31,231 (2006), 71 Fed. Reg. 63,680 (2006) (to be codified at 18 C.F.R. pt. 157) [hereinafter Order No. 686].

299. *Id.* at P 50.

300. Order No. 686, *supra* note 298, at P 3.

301. *Id.*

302. Order No. 686, *supra* note 298, at P 3.

303. Order No. 686-A, *Revisions to the Blanket Certificate Regulations and Clarification Regarding Rates*, F.E.R.C. STATS. & REGS. ¶ 31, 249 (2007), 72 Fed. Reg. 37,431 (2007) (to be codified at 18 C.F.R. pt. 157) [hereinafter Order No. 686-A].

tions to storage facilities to enhance injection and withdrawal capacity.<sup>304</sup> Order No. 686-A clarified that the enlargement of the scope of blanket certificate authority does not constrict the scope of activities that may be performed under section 2.55 of the Commission's regulations.<sup>305</sup> Thus, activities involving storage, mainline, and LNG and synthetic gas pipeline facilities that could have been performed under section 2.55 prior to the expansion of the blanket certificate program may continue to be performed under section 2.55. INGAA's rehearing request regarding the measurement of permissible noise levels from compressors constructed under blanket certificates has resulted in a further, separate rulemaking proceeding, which is pending.<sup>306</sup>

*E. Expansion of FERC's Authority to Coordinate the Review of Natural Gas Project Proposals and Maintain a Consolidated Federal Record*

Section 313 of the EPAct 2005 augmented the FERC's NGA authority over the authorization of proposed natural gas projects by directing the Commission to coordinate the environmental review and the issuance of all federal authorizations required for any application submitted pursuant to NGA sections 3 and 7.<sup>307</sup> Prior to the issuance of a final rule, the FERC issued an interim order delegating to the Director of the Office of Energy Projects (Director) a portion of the authority conferred by section 313.<sup>308</sup> In Order No. 687, issued in October 2006, the Commission established the schedule to be followed by federal agencies and state agencies acting pursuant to delegated federal authority for the issuance of additional permits, authorizations, certificates, opinions, or other approvals, and to maintain a complete consolidated record of decisions concerning such authorizations.<sup>309</sup> Since the issuance of Order No. 687, the Director has exercised the delegated authority on several occasions to issue schedules for environmental review.

1. EPAct 2005 Framework for Commission's Final Rule

Section 313 of EPAct 2005, enacted on August 8, 2005, amended section 15 of the NGA to provide the FERC with additional authority over the processing of natural gas project proposals submitted pursuant to NGA sections 3 and 7, by coordinating the timing of decisions of the various agencies with responsibilities over proposed natural gas projects.<sup>310</sup> In particular, section 313(a)(3) designates the FERC as the

lead agency for the purposes of coordinating all applicable Federal authorizations and for the purposes of complying with the National Environmental Policy Act of 1969 [NEPA] . . . Each Federal and State agency considering an aspect of an appli-

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304. *Id.* at P 9.

305. Order No. 686-A, *supra* note 303, at P 7.

306. *Revisions to the Blanket Certificate Regulations and Clarification Regarding Rates*, 117 F.E.R.C. ¶ 61,074, at P 56 (2006).

307. Energy Policy Act, *supra* note 62, § 313.

308. *Coordinated Processing of NGA Section 3 and 7 Proceedings*, 113 F.E.R.C. ¶ 61,170 (2005) [hereinafter Delegation Order].

309. *Id.*

310. Energy Policy Act, *supra* note 62, § 313.

cation for Federal authorization shall cooperate with the Commission and comply with the deadlines established by the Commission.<sup>311</sup>

Further, section 13(a)(3) provides that the Commission “shall establish a schedule for all Federal authorizations” and other approvals required for a proposal submitted pursuant to NGA section 3 or 7.<sup>312</sup> The schedule “[shall] (A) ensure expeditious completion of all such proceedings; and (B) comply with applicable schedules established by Federal law.”<sup>313</sup> An applicant is permitted under section 313(c)(2) to “pursue remedies” if a federal or state agency fails to complete a proceeding concerning the issuance of any approvals required for federal authorization in accordance with the schedule established by the FERC.<sup>314</sup>

Section 313(a)(3) also requires the Commission, with the cooperation of federal and state agencies, to “maintain a complete consolidated record of all decisions made and actions taken by the Commission” and other federal agencies concerning these authorizations, for the purpose of appeals or judicial review of such decisions and actions.<sup>315</sup>

## 2. Delegation of Commission Authority to the Director

On November 17, 2005, the Commission issued an Interim Order<sup>316</sup> delegating to the Director the authority to “execute certain of the responsibilities vested with the Commission by EAct 2005” and “to establish deadlines for all federal authorizations necessary for NGA section 3 and 7 proposals.”<sup>317</sup> The Commission asserted its belief that the processing of NGA section 3 and 7 project proposals filed prior to the effective date of its final rule could benefit from the immediate application of the additional authority conferred on the Commission by the EAct 2005.<sup>318</sup>

As such, the Commission granted the Director the authority to “coordinate with federal and state agencies for the purpose of scheduling the completion of the analyses and decisionmaking necessary for federal authorization of section 3 and 7 proposals.”<sup>319</sup> The Commission expected the Director to exercise the delegated authority “on a flexible, case-by-case basis, to Section 3 and 7 proposals filed prior to the effective date of a final rule, including proposals filed prior to the enactment of EAct 2005” and the Director had the discretion to forego the establishment of deadlines in proceedings that are relatively close to completion.<sup>320</sup> Decisions of the Director are subject to Commission review.<sup>321</sup>

While the Commission was directed by the EAct 2005 to establish a schedule for all necessary federal authorizations, the terms of the delegation to the

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311. *Id.* § 313(a)(3).

312. Energy Policy Act, *supra* note 62, § 313(a)(3).

313. *Id.*

314. Energy Policy Act, *supra* note 62, § 313(a)(3).

315. *Id.*

316. Delegation Order, *supra* note 308.

317. *Id.* at PP 1, 3.

318. Delegation Order, *supra* note 308, at P 7.

319. *Id.* at P 8.

320. Delegation Order, *supra* note 308, at P 9.

321. *Id.*

Director required coordination with other federal and state agencies to schedule the completion of the reports necessary for federal authorization.

### 3. Commission's Final Rule

On October 19, 2006, the Commission issued its Final Rule, Order No. 687,<sup>322</sup> implementing section 313 of EPAct 2005 and establishing regulations for the Commission's exercise of authority to coordinate the processing of federal authorizations for applications filed pursuant to NGA section 3 or 7. Order No. 687 became effective on December 26, 2006.<sup>323</sup>

In its role as "lead agency" under section 313,<sup>324</sup> the Final Rule: (1) establishes the schedule for other federal agencies and state agencies acting under federally-delegated authority to review requests for federal authorizations required for an NGA section 3 or 7 project; and (2) establishes the procedures to be used to compile a record of the FERC's decision and each agency's decision (as well as an index), to serve as a consolidated record in the event of an appeal or judicial review.<sup>325</sup> The procedures in the Final Rule do not apply to activities that do not involve an application for authorization under section 3 or section 7, nor do the new rules apply to projects authorized pursuant to the blanket certificate program.<sup>326</sup>

Pursuant to the Final Rule, the Commission will now issue a notice describing the schedule for its environmental review in compliance with the NEPA, as part of, or within ninety days of, its initial notice of an application.<sup>327</sup> Providing notice at this early stage in the authorization process informs the other agencies as to their respective due dates to issue final decisions on any requests for federal authorizations.<sup>328</sup> The notice of the schedule for the environmental review will state, among other milestones, the anticipated date for the FERC's completion of its Environmental Assessment (EA) or Final Environmental Impact Statement (FEIS).<sup>329</sup> In addition, for applications under NGA sections 3 and 7, a final decision on a request for federal authorization is due no later than ninety days after the Commission issues its final environmental document, unless a schedule is otherwise established by federal law.<sup>330</sup>

322. Order No. 687, *Regulations Implementing the Energy Policy Act of 2005; Coordinating the Processing of Federal Authorizations for Applications under Sections 3 and 7 of the Natural Gas Act and Maintaining a Complete Consolidated Record*, III F.E.R.C. STATS. & REGS. ¶ 31,232 (2006), 71 Fed. Reg. 62,912 (2006) (to be codified at 18 C.F.R. pts. 153, 157, 375, 385) [hereinafter Order No. 687]. The Commission had issued a Notice of Proposed Rulemaking inviting public comment in Docket No. RM06-1, on May 18, 2006. Notice of Proposed Rulemaking, *Regulations Implementing the Energy Policy Act of 2005: Coordinating the Processing of Federal Authorizations for Applications under Sections 3 and 7 of the Natural Gas Act and Maintaining a Complete Consolidated Record*, F.E.R.C. STAT & REGS. ¶ 32,602 (2006), 71 Fed. Reg. 30,632 (2006).

323. Order No. 687, *supra* note 322.

324. Energy Policy Act, *supra* note 62, § 313(a)(3).

325. Order No. 687, *supra* note 322, at P 2.

326. *Id.* at PP 30-31.

327. Order No. 687, *supra* note 322, at PP 13, 15; *see also* 18 C.F.R. § 157.9(b) (2006).

328. Order No. 687, *supra* note 322, at P 15.

329. *Id.* at P 13.

330. 18 C.F.R. § 157.22 (2006).

The Final Rule and the Commission's implementing regulations provide that, within thirty days of receiving an authorization request, an agency must inform the FERC:

- (1) whether the agency deems the application to be ready for processing and, if not, what additional information or materials will be necessary to assess the merits of the request;
- (2) the time the agency will allot the applicant to provide the necessary additional information or materials;
- (3) what, if any, studies will be necessary in order to evaluate the request;
- (4) the anticipated effective date of the agency's decision; and
- (5) if applicable, the schedule set forth by federal law for the agency to act.<sup>331</sup>

This submission by the agency is intended to enable the FERC to determine a realistic timetable for the environmental review process.<sup>332</sup> Also, a federal agency or state agency acting pursuant to delegated federal authority must file with the FERC a copy of any data request submitted to an applicant within ten business days.<sup>333</sup>

The Final Rule also implements section 313(d) of EPAct 2005 by establishing the procedures for the Commission to maintain the consolidated record of the FERC's decisions and the decisions of other agencies for federal authorization.<sup>334</sup> The Commission imposes a reporting requirement on other federal agencies issuing decisions or approvals necessary for proposed NGA section 3 or 7 projects, by requiring the agencies to provide the FERC with a copy of the final decision reached, or a summary thereof, and an index identifying each item in the record, within thirty days of the issuance of the final decision.<sup>335</sup> The rules do not require other agencies to reproduce and transmit the contents of their entire record, but the agencies must retain all of the original materials indexed in the record for a minimum of three years, or until an appeal or review is concluded.<sup>336</sup>

#### 4. Issuance of Notices by the Director

Since the effective date of Order No. 687, the Director has issued notices of a schedule for environmental review on at least six occasions. The Director's notices followed the notices of application issued by the Commission and identified the FERC Staff's planned schedules for the ninety-day federal authorization action deadline. All six notices have been issued since March 27, 2007.<sup>337</sup> In

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331. Order No. 687, *supra* note 322, at P 21; *see also* 18 C.F.R. § 2013(a) (2006).

332. Order No. 687, *supra* note 322, at P 22.

333. 18 C.F.R. § 385.2013(b) (2006).

334. Order No. 687, *supra* note 322, at P 36.

335. *Id.* at PP 39, 41; *see also* 18 C.F.R. § 385.2014(a) (2006).

336. Order No. 687, *supra* note 322, at P 42.

337. Notice of Schedule for Environmental Review for the Southeast Supply Header Project, *Southeast Supply Header, LLC*, Docket Nos. CP07-44-000, CP07-45-000 (F.E.R.C. Mar. 27, 2007); Notice of Schedule for Environmental Review for the Gulfstream Phase IV Project, *Gulfstream Natural Gas Sys., LLC*, Docket No. CP07-51-000 (F.E.R.C. Apr. 2, 2007); Notice of Schedule for Environmental Review for the Egan Fourth Cavern Project, *Egan Hub Storage, LLC*, Docket No. CP07-88-000 (F.E.R.C. May 30, 2007); Notice of Schedule for Environmental Review North Welda Storage Field Expansion Project, *Southern Star Cent. Gas Pipeline, Inc.*, Docket No. CP07-89-000 (F.E.R.C. June 1, 2007); Notice of Schedule for Environmental Review for the Tres Palacios Gas Storage Project, *Tres Palacios Gas Storage, LLC*, Docket No. CP07-90-000 (F.E.R.C. June 8, 2007); Notice of Schedule for Environmental Review for the Redfield Expansion 2008 Project, *Northern Nat. Gas Co.*, Docket No. CP07-108-000 (F.E.R.C. June 12, 2007).



the two instances in which the underlying section 7 applications were submitted before the effective date of Order No. 687, the Director also provided the deadlines for the issuance of a notice of availability for the EA or EIS (draft and final) and a closing date for the comment period.<sup>338</sup> In the four instances in which the notice of schedule concerns section 7 applications submitted after the effective date of Order No. 687, the notice also includes the target deadline for the issuance of the EA.<sup>339</sup> The notices provide that if the schedule changes, an additional notice would be issued so that the relevant agencies are informed of the project's progress.

#### F. Alaska Pipeline Developments

A multi-year effort by the three major North Slope Producers to reach an agreement with the State of Alaska that would support a producer-owned pipeline has been replaced by a new plan sponsored by the Governor of Alaska, Sarah Palin. Under the prior Murkowski administration, and pursuant to federal and state legislation (the Alaska Natural Gas Pipeline Act<sup>340</sup> and the Alaska Stranded Gas Development Act<sup>341</sup>), the North Slope Producers sought approval of a fiscal contract that would determine the State's participation in the project and would ensure attractive tax and royalty standards once the project was in service. However, legislative approval of the fiscal contract was not achieved in 2006, before the Palin administration replaced the Murkowski administration.

Governor Palin embarked upon a plan to bring other competitors into the pipeline-proposal process, to increase benefits to the State from a gas pipeline, and to protect the interests of explorer producers, those producers other than the North Slope Producers who are awaiting the outcome of pipeline deliberations before making their commitments.<sup>342</sup> The result was the Alaska Gasline Inducement Act (AGIA), proposed in March of 2007, passed in mid-May, and signed into law on June 6, 2007.<sup>343</sup>

Under the AGIA, applications are sought for a "license" to be the State's favored pipeline developer. Such license would carry with it certain benefits for the license holder:

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338. Notice of Schedule for Environmental Review for the Southeast Supply Header Project, *Southeast Supply Header, LLC*, Docket Nos. CP CP07-44-000, CP07-45-000 (F.E.R.C. Mar. 27, 2007); Notice of Schedule for Environmental Review for the Gulfstream Phase IV Project, *Gulfstream Natural Gas Sys., LLC*, Docket No. CP07-51-000 (F.E.R.C. Apr. 2, 2007).

339. Notice of Schedule for Environmental Review for the Egan Fourth Cavern Project, *Egan Hub Storage, LLC*, Docket No. CP07-88-000 (F.E.R.C. May 30, 2007); Notice of Schedule for Environmental Review North Welda Storage Field Expansion Project, *Southern Star Cent. Gas Pipeline, Inc.*, Docket No. CP07-89-000 (F.E.R.C. June 1, 2007); Notice of Schedule for Environmental Review for the Tres Palacios Gas Storage Project, *Tres Palacios Gas Storage, LLC*, Docket Nos. CP07-90-000 (F.E.R.C. June 8, 2007); Notice of Schedule for Environmental Review for the Redfield Expansion 2008 Project, *Northern Nat. Gas Co.*, Docket No. CP07-108-000 (F.E.R.C. June 12, 2007).

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

341. ALASKA STAT. § 43.82-43.82.990 (2007).

342. STATE OF ALASKA, ADMINISTRATION WHITE PAPER ON AGIA, [http://www.dog.dnr.state.ak.us/agia/pdf/agia\\_docs/agia\\_whitepaper.pdf](http://www.dog.dnr.state.ak.us/agia/pdf/agia_docs/agia_whitepaper.pdf) (last visited Sept. 19, 2007).

343. ALASKA STAT. § 43.90-43.90.990 (2007).

- (1) A contribution by the State of up to \$500 million toward pre-certificate-application development costs;<sup>344</sup>
- (2) Expedited permitting by the State and the designation of a State Gasoline Coordinator to help streamline the permitting process;<sup>345</sup>
- (3) State-funded training of construction and operation personnel; and
- (4) Production incentives (in the tax and royalty process) for shippers committing to the licensed pipeline.<sup>346</sup>

Applicants for a license must meet various requirements, including a commitment to firm deadlines for open seasons and certificate applications, support for rolled-in pricing of future expansions within limits, and multiple cost-containment, financial commitment, and in-state delivery commitment obligations. The State has issued its Request for Applications in early July, with the applications being due by October 1, 2007.<sup>347</sup>

The North Slope Producers and some other developers have repeatedly expressed multiple concerns with the structure and process of the AGIA. Thus, it is unknown at this time who will apply for a license and/or who will commit to a winning pipeline in a binding open season.

#### IV. NATURAL GAS QUALITY AND INTERCHANGEABILITY

##### A. *Interchangeability Policy Statement*

Since its release on June 15, 2006, the Commission's Policy Statement on Natural Gas Quality and Interchangeability has continued to shape the discussion of gas quality and interchangeability issues.<sup>348</sup> The Interchangeability Policy Statement details five principles that the Commission hopes will provide certainty, ensure the safety and reliability of the nation's gas grid, and provide enough flexibility to maximize the introduction of new supply onto the interstate gas grid.<sup>349</sup> The five principles embodied in the Interchangeability Policy Statement are:

- (1) only natural gas quality and interchangeability specifications contained in a Commission-approved gas tariff can be enforced;
- (2) pipeline tariff provisions on gas quality and interchangeability need to be flexible to allow pipelines to balance safety and reliability concerns with the importance of maximizing supply, as well as recognizing the evolving nature of the science underlying gas quality and interchangeability specifications;
- (3) pipelines and their customers should develop gas quality and interchangeability specifications based on technical requirements;
- (4) in negotiating technically based solutions, pipelines and their customers are strongly encouraged to use the Natural Gas Council Plus (NGC+) Interim Guide-

344. *Id.* § 43.90.110.

345. ALASKA STAT. § 43.90.470.

346. *Id.* § 43.90.310.

347. SARAH PALIN, GOVERNOR OF ALASKA, REQUEST FOR APPLICATIONS: ALASKA GASLINE INDUCEMENT ACT (2007) [http://www.dog.dnr.state.ak.us/agia/agia\\_rfa\\_modified8\\_6\\_07.pdf](http://www.dog.dnr.state.ak.us/agia/agia_rfa_modified8_6_07.pdf).

348. *Natural Gas Interchangeability*, 115 F.E.R.C. ¶ 61,325 (2006) [hereinafter *Interchangeability Policy Statement*]. The last Report of the Natural Gas Regulation Committee discussed the *Interchangeability Policy Statement* in detail. See *Report of the Natural Gas Regulation Committee*, 27 ENERGY L.J. 623, 636-39 (2006).

349. *Interchangeability Policy Statement*, *supra* note 348, at P 24.

lines filed with the Commission on February 28, 2005 . . . as a common reference point for resolving gas quality and interchangeability issues; and, (5) to the extent pipelines and their customers cannot resolve disputes over gas quality and interchangeability, those disputes can be brought before the Commission to be resolved on a case-by-case basis, on a record of fact and technical review.<sup>350</sup>

The Commission has utilized these principles in several orders over the past year.

### B. Recent Gas Quality and Interchangeability Proceedings

#### 1. AES Ocean Express, LLC v. Florida Gas Transmission Company (Docket Nos. RP04-249-001, CP05-388-000, CP06-1-000)

On April 11, 2006, the Presiding ALJ issued an Initial Decision recommending natural gas interchangeability standards on Florida Gas Transmission Company's (FGT) pipeline facilities.<sup>351</sup> On April 20, 2007, the Commission issued its Opinion and Order on Initial Decision in which the Commission generally upheld the ALJ's Initial Decision.<sup>352</sup> The Commission, however, reversed the ALJ on the five following topics: methane number, minimum BTU, total sulfur ceiling, modification of FGT's Western Division interchangeability standards, and application of a single set of standards to all gas (not just vaporized liquefied natural gas (LNG)) in FGT's Market Area. The following table shows the standards approved for FGT's Market Area.<sup>353</sup>

	<b>Initial Decision</b>	<b>Opinion No. 495</b>	<b>Affirm or Reverse</b>
<b>Wobbe Index</b>	1340 - 1396	1340 – 1396	Affirm
<b>Wobbe Rate Of Change</b>	≤ 2% per 6 min.	≤ 2% per 6 min.	Affirm
<b>Heat Content (HHV) (Btu)</b>	1025 - 1110	1000 – 1110	Reverse
<b>Methane Number</b>	≥ 80	None	Reverse
<b>C<sub>1</sub> %</b>	≥ 85	≥ 85	Affirm
<b>C<sub>2</sub> %</b>	≤ 10	≤ 10	Affirm
<b>C<sub>3</sub> %</b>	≤ 2.75	≤ 2.75	Affirm
<b>C<sub>4+</sub> %</b>	≤ 1.2	≤ 1.2	Affirm
<b>C<sub>5+</sub> %</b>	≤ 0.12	≤ 0.12	Affirm
<b>Comb. CO<sub>2</sub> and N<sub>2</sub> %</b>	≤ 3	≤ 3	Affirm

350. *Id.* at P 2.

351. *AES Ocean Express LLC v. Florida Gas Transmission Co.*, 115 F.E.R.C. ¶ 63,009 (2006) [hereinafter Initial Opinion]. The last Report of the Natural Gas Regulation Committee discussed the *Initial Decision* in detail. *See Report of the Natural Gas Regulation Committee*, 27 ENERGY L.J. 623, 642-43 (2006).

352. Opinion No. 495, *AES Ocean Express LLC v. Florida Gas Transmission Co.*, 119 F.E.R.C. ¶ 61,075 (2007) [hereinafter Opinion No. 495].

353. *Id.* at PP 26, 34, 131, 155, 171.

<b>CO<sub>2</sub> %</b>	≤ 1 and 0% as Dilutant	≤ 1 and 0% as Dilutant	Affirm
<b>O<sub>2</sub> %</b>	≤ 0.25	≤ 0.25	Affirm
<b>H<sub>2</sub>S</b>	≤ 0.25	≤ 0.25	Affirm
<b>Sulfur (g/cf)</b>	≤ 2	≤ 10	Reverse
<b>Water vapor (lb/MMcf)</b>	≤ 7	≤ 7	Affirm
<b>Max. Temp. (degree F)</b>	≤ 120	≤ 120	Affirm
<b>Min. Temp. (degree F)</b>	Case-by-Case	Case-by-Case	Affirm

The Commission's long-anticipated order affirmed the ALJ's conclusion that FGT's proposed Wobbe Index range of 1340 to 1396 is just and reasonable. While it relied on the Interchangeability Policy Statement and NGC+ Interim Guidelines, the Commission concluded "the special requirements of the electric generators" support FGT's proposed Wobbe Index range (i.e., ±2% allowable variation from the midpoint, with an upper limit of 1396), instead of the NGC+ Interim Guidelines' ±4% variation, with an upper limit of 1400.<sup>354</sup>

In his Initial Decision, the ALJ determined that the NGA section 4<sup>355</sup> standards of proof applied to this proceeding.<sup>356</sup> Reversing the ALJ, the Commission concluded in Opinion No. 495 that NGA section 5<sup>357</sup> standards applied because the case evolved from a NGA section 5 complaint.<sup>358</sup> Nevertheless, where the pipeline admits that its tariff is not just and reasonable, the Commission concluded that it would give deference to the pipeline's just and reasonable proposal even if other just and reasonable provisions have been proposed.<sup>359</sup> In this case, the Commission approved (with amendments) FGT's proposal because it (as amended) was just and reasonable.<sup>360</sup> The Commission ruled that if the ALJ gave deference to FGT then such deference was appropriate.<sup>361</sup>

The ALJ concluded in the Initial Decision that the same gas interchangeability provisions should apply to FGT entire system, including both FGT's Market Area and FGT's Western Division.<sup>362</sup> The Commission reversed on this matter.<sup>363</sup> The Commission held that the record did not support a finding that FGT's Western Division standards were not just and reasonable.<sup>364</sup> As a result, the

354. Opinion No. 495, *supra* note 352, at P 44.

355. 15 U.S.C. § 717d (2000).

356. Opinion No. 495, *supra* note 352, at P 18.

357. 15 U.S.C. § 717d (2000).

358. Opinion No. 495, *supra* note 352, at P 23.

359. *Id.* at P 25.

360. Opinion No. 495, *supra* note 352, at P 26.

361. *Id.*

362. Initial Opinion, *supra* note 351, at PP 198-201.

363. Opinion No. 495, *supra* note 352, at P 227.

364. *Id.* at P 228.

Commission did not change any standards applicable to FGT's Western Division and FGT's historic Western Division standards remain in place.<sup>365</sup>

The ALJ concluded in the Initial Decision that the new gas interchangeability provisions only should apply to vaporized LNG, not native gas.<sup>366</sup> The Commission reversed on this matter.<sup>367</sup> The Commission concluded in Opinion No. 495 that the new gas interchangeability provisions should apply to all gas in FGT's Market Area regardless of its source or origination.<sup>368</sup> The Commission also found that dual standards differentiating between vaporized LNG and native gas could be unworkable because vaporized LNG may enter FGT's Market Area already blended with domestic gas.<sup>369</sup>

The ALJ found in the Initial Decision that the prospective mitigation costs raised at hearing were speculative as to their need, amount, and cause.<sup>370</sup> The ALJ rejected calls to initiate a program providing for end user recovery of their mitigation costs.<sup>371</sup> The Commission affirmed the ALJ's decision that no cost recovery mechanism should be established in this proceeding for consumers to recover mitigation costs.<sup>372</sup>

In Opinion No. 495, the Commission further found that no such cost recovery mechanism should be established in future FGT proceedings.<sup>373</sup> The Commission reasoned that in cases where all parties have had the opportunity to contest proposed standards and the Commission determines that the proposed standards are just and reasonable, then the Commission will not act further to provide for recovery of any mitigation cost by non-jurisdictional downstream gas users—primarily because the Commission lacks jurisdiction with respect to such matters, except in unusual circumstances.<sup>374</sup>

In this case, the Commission's only relevant jurisdiction is over FGT's rates, terms, and conditions for interstate transportation service.<sup>375</sup> The Commission has no jurisdiction with respect to any of the purchases or sales that may bring LNG into the market or the entities that may incur mitigation costs.<sup>376</sup> Having approved just and reasonable standards, the Commission found no basis to assert jurisdiction over the allocation and recovery of downstream entities' mitigation costs.<sup>377</sup> To have jurisdiction, the Commission would need some basis to find that the mitigation cost recovery mechanism would ensure that FGT

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365. Opinion No. 495, *supra* note 352, at P 228. The Commission reiterated this conclusion when it rejected a portion of FGT's compliance filing in Docket No. CP06-1-003: "However, proposed section 2.A.9 is contrary to Opinion No. 495, which specifically held that there would be no change to the gas receipt standards for the Western Division as a result of this proceeding." *Florida Gas Transmission Co.*, 119 F.E.R.C.

¶ 61,185, at P 9 (2007).

366. Opinion No. 495, *supra* note 352, at P 209.

367. *Id.* at P 212.

368. Opinion No. 495, *supra* note 352, at P 212.

369. *Id.* at P 218.

370. Opinion No. 495, *supra* note 352, at PP 251-252.

371. *Id.*

372. Opinion No. 495, *supra* note 352, at P 261.

373. *Id.*

374. Opinion No. 495, *supra* note 352, at P 261.

375. *Id.* at P 269.

376. Opinion No. 495, *supra* note 352, at P 269.

377. *Id.* at 272.

“recovers its costs of providing jurisdictional transportation service from its customers . . . .”<sup>378</sup> The mitigation costs are not FGT’s costs but are the customer’s cost of testing and modifying their own equipment.<sup>379</sup> No nexus was shown between FGT’s cost of providing service and the downstream entities’ mitigation costs.<sup>380</sup> Allocation of costs to importers, sellers, and purchasers would involve the Commission in matters that are beyond its NGA responsibilities.<sup>381</sup>

Finally, the Commission stated that it could not use its conditioning power in a certificate proceeding to require an LNG project developer to collect and disperse mitigation costs.<sup>382</sup> The Commission noted that the courts have found that the Commission cannot use the certificate conditions to do indirectly something that it can do only by satisfying NGA safeguards or things that it cannot do at all.<sup>383</sup>

The parties submitted rehearing requests in May 2007.

2. *Norstar Operating LLC v. Columbia Gas Transmission Corp.*  
(Docket Nos. RP06-231-002, RP06-365-000)

This proceeding addresses a complaint filed by Norstar Operating, LLC (Norstar) against Columbia Gas Transmission Corporation (Columbia Gas) in which Norstar alleged that Columbia Gas violated its tariff and the NGA by refusing to accept deliveries of natural gas that satisfied Columbia Gas’ tariff specifications but failed to meet specifications set forth outside of the tariff.<sup>384</sup> In this case, Columbia Gas included a 4% nitrogen cap in its standard Meter Set Agreements (MSA) instead of its tariff.<sup>385</sup>

On April 21, 2006, the Commission held that the 4% nitrogen cap in the standard MSA did not violate the tariff because the tariff specifically authorized Columbia Gas to reflect additional specifications in its executed MSAs.<sup>386</sup> The Commission, therefore, specifically determined that it would not require Columbia Gas to cease enforcing the gas quality standards in its MSAs.<sup>387</sup>

The Commission, however, also found that Columbia Gas’ ability under its tariff to impose different gas quality standards in an MSA was unjust and unreasonable because it was “too broad and too vague” and gave Columbia Gas “too much discretion . . . without adequate protections . . . .”<sup>388</sup> The Commission initiated an NGA section 5 proceeding to determine the just and reasonable tariff provision to replace the provision rejected by the Commission.<sup>389</sup> The Commis-

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378. Opinion No. 495, *supra* note 352, at P 273.

379. *Id.* at P 272.

380. Opinion No. 495, *supra* note 352, at P 273.

381. *Id.*

382. Opinion No. 495, *supra* note 352, at PP 290-91.

383. *Id.* at P 291.

384. *Norstar Operating, LLC v. Columbia Gas Transmission Corp.*, 115 F.E.R.C. ¶ 61,351, at P 2 (2006).

385. *Id.*

386. *Norstar Operating, LLC v. Columbia Gas Transmission Corp.*, 115 F.E.R.C. ¶ 61,094, at P 19 (2006).

387. *Id.*

388. 115 F.E.R.C. ¶ 61,094, at P 20.

389. *Id.* at P 20.

sion, therefore, directed Columbia Gas to file new tariff provisions,<sup>390</sup> with the admonition that Columbia Gas must not use the flexibility afforded under its tariff to impose what are, in effect, permanent gas quality standards without including those standards in its tariff.<sup>391</sup>

Columbia Gas submitted two related filings on May 22, 2006: a compliance filing and tariff sheets implementing new gas quality provisions. The proposed gas quality provisions generally followed the provisions historically contained in Columbia Gas' MSAs.<sup>392</sup> The proposed standards fall into four main categories: (a) receipt point specification to control gas quality, (b) receipt point specifications to control interchangeability, (c) delivery point specifications, and (d) provisions giving Columbia Gas the ability to either accept gas that does not meet the receipt point specification or reject gas that does meet those specifications.<sup>393</sup> On June 21, 2006, the Commission issued an order accepting and suspending these Columbia Gas tariff sheets and establishing a technical conference.<sup>394</sup> The Commission held a technical conference on July 25, 2006.

On March 16, 2007, the Commission issued an Order on Technical Conference in which the Commission upheld most of Columbia Gas' proposed standards based, at least in part, on the minimal gas quality problems historically experienced by Columbia Gas when using the similar standards in its MSAs.<sup>395</sup>

Columbia Gas had sought a 15° F cricondentherm hydrocarbon dew point (CHDP) Safe Harbor to address gas quality issues. The Commission rejected the Safe Harbor because Columbia Gas provided "virtually no system data to support its request."<sup>396</sup> Columbia Gas also failed to follow the process set out in the NGC+ HDP whitepaper or show that liquid drop out would occur in any of the pressure reduction points.<sup>397</sup> In place of the 15° F CHDP, the Commission required Columbia Gas to move the 25° F CHDP limit from its standard MSA to its tariff because there was no evidence of operational issues related to the 25° F CHDP.<sup>398</sup> The Commission contrasted this decision, based on Columbia Gas' failure to produce evidence showing the proposed limit was needed, with its decisions in *ANR Pipeline Co.* and *NGPL*, where the pipelines had produced substantial evidence in support of its safe harbor limit.<sup>399</sup>

The Commission accepted Columbia Gas' proposed Wobbe Index standard (1350 ± 4%, subject to a maximum of 1400), heating value (967-1110 BTU/scf), nitrogen (4%), carbon dioxide (1.25%), oxygen (0.02%), sulfur (2 gr/100 scf), maximum temperature (120° F), and water (7 lbs/Mscf) standards, finding these

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390. 115 F.E.R.C. ¶ 61,351, at P 20.

391. *Id.* at P 21.

392. *Norstar Operating, LLC v. Columbia Gas Transmission Corp.*, 118 F.E.R.C. ¶ 61,221, at P 13 (2007).

393. *Id.* at P 14.

394. 115 F.E.R.C. ¶ 61,351 (2006).

395. 118 F.E.R.C. ¶ 61,221 (2007).

396. *Id.* at P 33.

397. 118 F.E.R.C. ¶ 61,221, at P 33.

398. *Id.* at PP 35-37.

399. 118 F.E.R.C. ¶ 61,221, at P 33 n.25 (citing *ANR Pipeline Co.*, 116 F.E.R.C. ¶ 61,002, at PP 91-02, *reh'g denied*, 117 F.E.R.C. ¶ 61,286, at PP 41-49 (2006); *Natural Gas Pipeline Co. of America* 116 F.E.R.C. ¶ 61,262 (2006)). The *ANR* and *NGPL* proceedings are described in the following two subsections.

specifications to be just and reasonable.<sup>400</sup> The Commission also found the proposed Wobbe Index and heating value standards to be consistent with the Interchangeability Policy Statement, and consistent with the Columbia Gas' history.<sup>401</sup> The Commission accepted Columbia Gas' proposal to exempt natural gas from the Appalachian Basin from the Wobbe Index and maximum heating value limitations on the ground that the NGC+ Interim Guidelines permitted exceptions for service territories with demonstrated experience with gas supplies with greater heating values.<sup>402</sup>

The Commission rejected Columbia Gas' proposed delivery point standard finding it to be unsupported, unjust, and unreasonable.<sup>403</sup> Moreover, the Commission required Columbia Gas to retain its existing merchantability language and make it applicable to Columbia Gas deliveries.<sup>404</sup>

The Commission approved Columbia Gas' proposed waiver provisions and Columbia Gas' stated intent to waive immediately both the 4% total inerts limit and the 1.25% carbon dioxide limit.<sup>405</sup>

Finally, the Commission accepted Columbia Gas' compliance filing, but required Columbia Gas to remove or revise the proposed provision which would have reserved to Columbia Gas the right to impose revised quality specifications.<sup>406</sup> The Commission found that the proposed provision was "virtually the same as the provisions that the Commission found to be unjust and unreasonable in the Complaint Order and is unjust and unreasonable for the same reasons."<sup>407</sup> Parties filed rehearing requests on May 16, 2007.

### 3. ANR Pipeline Company (Docket No. RP04-435-000)

As described in the last Report of the Natural Gas Regulation Committee, ANR Pipeline Company (ANR) filed revised tariff sheets proposing CHDP specifications in late 2004.<sup>408</sup> That tariff filing was set for evidentiary hearing before ALJ Edward M. Silverstein.<sup>409</sup> ANR filed an Offer of Settlement on September 30, 2005.<sup>410</sup> The Offer of Settlement included revised tariff sheets allowing for a 15° F hydrocarbon dew point (HDP) Safe Harbor.<sup>411</sup> The ALJ

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400. *Id.* at PP 41, 50, 66, 72, 76, 101, 113, 116, & 118.

401. 118 F.E.R.C. ¶ 61,221, at P 50 (2007).

402. *Id.* at PP 63-64.

403. 118 F.E.R.C. ¶ 61,221, at P 133.

404. *Id.* at P 135.

405. 118 F.E.R.C. ¶ 61,221, at PP 146-47, 151.

406. *Id.* at PP 159-60.

407. *Norstar Operating, LLC v. Columbia Gas Transmission Corp.*, 118 F.E.R.C. ¶ 61,221, at P 159 (2007).

408. *Report of the Natural Gas Regulation Committee*, 27 ENERGY L.J. 623, 644 (2006) (citing *ANR Pipeline Company*, 113 F.E.R.C. ¶ 63,021 (2005)).

409. *ANR Pipeline Co.*, 108 F.E.R.C. ¶ 61,323, at P 1 (2004) [hereinafter *ANR Pipeline Co.*]; see also Order of Chief Judge Designating Presiding Administrative Law Judge, *ANR Pipeline Co.*, Docket No. RP04-435-000 (F.E.R.C. Oct. 1, 2004).

410. Offer of Settlement, Explanatory Statement and Motion for Omission of Initial Decision, *ANR Pipeline Co.*, Docket No. RP04-435-000 (F.E.R.C. Sept. 30, 2005).

411. *Id.* at 1.



certified the Settlement to the Commission as a contested settlement on November 15, 2005.<sup>412</sup>

On July 3, 2006, the Commission issued an Order on Contested Settlement.<sup>413</sup> In that order, the Commission approved the settlement without condition.<sup>414</sup> The Commission found that ANR supported the proposed 15° F CHDP Safe Harbor with unrebutted substantial evidence.<sup>415</sup>

The Commission also concluded that ANR may reasonably take into consideration its ability to make deliveries to downstream interconnects, but that ANR is not required to base its CHDP Safe Harbor on the operating conditions on downstream pipelines.<sup>416</sup> The Commission noted that an important consideration when an upstream pipeline establishes gas quality standards, including CHDP Safe Harbor provisions, is the ability of downstream entities to accept the gas that the upstream pipeline will be delivering to them.<sup>417</sup> The Commission, however, concluded that “it would be inappropriate to . . . allow a single downstream entity, with special needs, to dictate the gas quality standards that all gas entering the upstream pipeline system must meet.”<sup>418</sup> The Commission based its conclusion on three factors: (a) “processing gas can be expensive . . . it may well be more efficient to address the special needs of a few downstream entities through such strategies as the installation of heaters, [for example] rather than requiring that all gas entering the upstream pipeline’s system be more subject to more expensive processing than is necessary”;<sup>419</sup> (b) the “worst case downstream scenario approach could result in less gas commodity available for the interstate market” if all gas supplies were required to meet the least-common denominator CHDP standard;<sup>420</sup> and (c) the “worst case downstream scenario approach could decrease pipeline throughput” and thereby possibly reduce operational flexibility of pipelines to offer transportation by displacement and exchange.<sup>421</sup>

On December 11, 2006, the Commission denied requests for rehearing.<sup>422</sup> On rehearing, the Commission confirmed that it “will not maintain a policy that a pipeline must set its receipt point gas quality standards so that gas received at a receipt point will be guaranteed never to result in any liquid fallout problems on any part of any downstream system.”<sup>423</sup> Accordingly, while the pipeline can consider downstream conditions, the Commission will not require a pipeline to meet all the standards of downstream customers.<sup>424</sup>

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412. *ANR Pipeline Co.*, 113 F.E.R.C. ¶ 63,021 (2005).

413. *ANR Pipeline Co.*, 116 F.E.R.C. ¶ 61,002 (2006).

414. *Id.* at PP 2, 42.

415. 116 F.E.R.C. ¶ 61,002, at P 2.

416. *Id.*

417. 116 F.E.R.C. ¶ 61,002, at P 56.

418. *Id.* at P 59.

419. *ANR Pipeline Co.*, 116 F.E.R.C. ¶ 61,002, at P 59 (2006).

420. *Id.* at P 60.

421. 116 F.E.R.C. ¶ 61,002, at P 61.

422. *ANR Pipeline Co.*, 117 F.E.R.C. ¶ 61,286 (2006).

423. *Id.* at P 27.

424. 117 F.E.R.C. ¶ 61,286, at P 27.

Among other things, the Commission also affirmed its earlier conclusion that the 15° F CHDP Safe Harbor was consistent with the NGC+ Whitepaper as required by the Interchangeability Policy Statement.<sup>425</sup>

ANR filed revised tariff sheets to implement the contested settlement on January 29, 2007. In a February 16, 2007 letter order, the Commission accepted this compliance filing effective March 1, 2007.<sup>426</sup>

4. Natural Gas Pipeline Company of America (Docket Nos. RP01-503-000, et al.)

In response to a Commission order, Natural Gas Pipeline Company of America (NGPL) filed revised tariff sheets that, among other things, established a permanent CHDP Safe Harbor.<sup>427</sup> On December 20, 2005, the Presiding ALJ issued an Initial Decision, finding the proposed tariff provision (including the 15° F CHDP Safe Harbor) to be just and reasonable.<sup>428</sup>

On September 21, 2006, the Commission issued an Order on Rehearing and Initial Decision that addressed both the ALJ's Initial Decision and requests for clarification or rehearing of the order initially setting the CHDP issue for hearing.<sup>429</sup> In the Order on Rehearing and Initial Decision, the Commission affirmed the ALJ's conclusion in the Initial Decision that NGPL's proposed 15° F CHDP Safe Harbor was just and reasonable.<sup>430</sup> The Commission also affirmed its earlier order that the CHDP Safe Harbor cannot be overridden by separate BTU limitation in the tariff or "changes in the requirements of downstream pipelines."<sup>431</sup> This order additionally established procedures to examine NGPL's need for an upper BTU limit consistent with the Interchangeability Policy Statement.<sup>432</sup> Namely, NGPL was required to make a new filing either changing its proposal concerning an upper BTU limit consistent with the Interchangeability Policy Statement or explaining how its current proposal is consistent with the Interchangeability Policy Statement and the NGC+ guidelines.<sup>433</sup> On March 16, 2007, the Commission denied a rehearing on the September 2006 Order on Rehearing and Initial Decision.<sup>434</sup>

On January 4, 2007, NGPL submitted the required tariff filing addressing interchangeability and maximum BTU limit. A technical conference on that filing was held on March 15, 2007 in which the following topics were addressed: (a) Are NGPL's tariff proposals consistent with the NGC+ Interim Guidelines; (b) To the extent NGPL's proposals are not consistent with those guidelines, has NGPL supported any divergence from them; and (c) Did NGPL use the appro-

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425. *Id.* at PP 41-49.

426. Letter Order, *ANR Pipeline Co.*, Docket No. RP04-435-006 (F.E.R.C. Feb. 16, 2007).

427. *Report of the Natural Gas Regulation Committee*, 27 ENERGY L.J. 623, 643 (2006) (citing *Natural Gas Pipeline Co. of America*, 102 F.E.R.C. ¶ 61,234, at P 1 (2003)).

428. *Natural Gas Pipeline Co. of America*, 113 F.E.R.C. ¶ 63,036, at P 32 (2005).

429. *Natural Gas Pipeline Co. of America*, 116 F.E.R.C. ¶ 61,262 (2006).

430. *Id.* at P 2.

431. 116 F.E.R.C. ¶ 61,262, at P 14.

432. *Id.* at P 32.

433. 116 F.E.R.C. ¶ 61,262, at P 32.

434. *Natural Gas Pipeline Co. of America*, 118 F.E.R.C. ¶ 61,219 (2007).

priate methodology to determine the Wobbe Index and BTU limits and, if not, what methodology should have NGPL used?<sup>435</sup>

5. Indicated Shippers v. Tennessee Gas Pipeline Company (Docket No. RP04-99-001) and Indicated Shippers v. Columbia Gulf Transmission Company (Docket No. RP04-98-001)

These pipeline's gas shippers initiated these proceedings in response to the posting of heat content and CHDP limits through pipeline notices rather than NGA section 4 filings.<sup>436</sup> In 2004, the Commission found that Tennessee Gas Pipeline Company (Tennessee) and Columbia Gulf Transmission Company (Columbia Gulf) both had the authority under their tariffs to impose the additional standards but that the authority was too vague and too broad.<sup>437</sup> The Commission, therefore, required the pipelines to modify their tariffs accordingly.<sup>438</sup>

Tennessee and Columbia Gulf submitted their initial compliance filing well before the Commission issued its Interchangeability Policy Statement. On August 1, 2006, the Commission issued two substantially similar orders in these two proceedings that—rather than substantively addressing the pipelines' compliance filings—directed the pipelines to update their compliance filings in light of the Interchangeability Policy Statement.<sup>439</sup> The Commission also established technical conferences to address the revised compliance filings.<sup>440</sup>

The Columbia Gulf submitted its revised compliance filing on January 5, 2007, and a technical conference on that filing was held on February 15, 2007.<sup>441</sup>

The Commission clarified the Tennessee order on September 28, 2006, by concluding that Tennessee Gas did not need to include in its compliance filing a tariff provision setting "specific HDP gas quality specifications for the gas that it will deliver at its delivery points."<sup>442</sup> Instead, it may "provide an explanation concerning the appropriateness of gas quality specifications for gas to be delivered to its customers."<sup>443</sup> On February 26, 2007, Tennessee Gas submitted an Offer of Settlement instead of a compliance filing and moved for suspension of both the compliance filing obligation and the subsequent technical conference while the Commission evaluated the merits of the Offer of Settlement.<sup>444</sup> Tennessee Gas states that the settlement establishes a 15° F CHDP safe harbor and

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435. Notice of Technical Conference, *Natural Gas Pipeline Co. of America*, Docket No. RP01-503-007 (F.E.R.C. Feb. 9, 2007).

436. *Indicated Shippers v. Columbia Gulf Transmission Co., Indicated Shippers*, 106 F.E.R.C. ¶ 61,040, at P 1 (2004).

437. *Id.* at P 36.

438. 106 F.E.R.C. ¶ 61,040, at P 1.

439. *Indicated Shippers v. Tenn. Gas Pipeline*, 116 F.E.R.C. ¶ 61,113, at P 1 (2006); *Indicated Shippers v. Columbia Gulf Transmission Co.*, 116 F.E.R.C. ¶ 61,112, at P 1 (2006).

440. *Id.*

441. Notice of Technical Conference, *Columbia Gulf Transmission Co.*, Docket No. RP04-98-002 (F.E.R.C. Feb. 7, 2006).

442. *Indicated Shippers v. Tenn. Gas Pipeline Co.*, 116 F.E.R.C. ¶ 61,302, at P 26 (2006).

443. *Id.*

444. Offer of Settlement, Explanatory Statement and Motion for Suspension of Compliance Filing and Technical Conference, *Tennessee Gas Pipeline Co.*, Docket No. RP04-99-002, at 1 (F.E.R.C. Feb. 26, 2007) [hereinafter TG Offer of Settlement].

implements tariff procedures posting CHDP limits and addressing requests for paring gas supplies to maximize supply.<sup>445</sup>

## V. CAPACITY RELEASE

### A. *Petition for Rulemaking of Pacific Gas and Electric Company and Southwest Gas Corporation, Docket No. RM06-21-000*

#### 1. The Petition

On August 1, 2006, Pacific Gas and Electric Company and Southwest Gas Corporation (collectively, Petitioners) filed a petition requesting the Commission to institute a rulemaking to remove the price cap on capacity release transactions. Petitioners believe the Commission should act now to amend “its regulations to allow shippers engaged in capacity release transactions to charge the replacement shipper a contractual rate that may be higher than the pipeline’s maximum tariff rate” because of current policy interests in expanding infrastructure and facilitating a competitive capacity market.<sup>446</sup>

Petitioners argued that the benefits of removing the cap on capacity release transactions contemplated in Order No. 637 still exist today. Those benefits include: increased efficiency, improved market transparency, more effective pricing signals, and mitigation of long-term capacity costs to the benefit of captive customers.<sup>447</sup> Petitioners asserted that “the data collected during the two-year period during which the cap for capacity release transactions was lifted demonstrate that the experiment succeeded.”<sup>448</sup> According to Petitioners, there is no risk of market manipulation. They contended that the safeguards set forth in Order No. 637 still exist, and that, if anything, the market is even more competitive than it was six years ago.<sup>449</sup> Petitioners also noted that under the EPAct 2005 the Commission has additional authority to identify and enforce penalties against market manipulation.<sup>450</sup>

#### 2. Request for Comments, Docket Nos. RM06-21-00 and RM07-4-000

On January 3, 2007, in response to the various parties’ petitions discussed above for clarification and rulemaking relating to the Commission’s regulations on capacity release, the Commission issued a formal notice and request for comments.<sup>451</sup> The “notice,” announced the Commission, “requests comment on the current operation of the Commission’s capacity release program and whether changes in any of its capacity release policies would improve the efficiency of the natural gas market.”<sup>452</sup>

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445. *Id.*

446. Petition for Rulemaking, *Pacific Gas and Elec. Co. Southwest Gas Corp.*, Docket No. RM06-21-000, at 3 (F.E.R.C. Aug. 1, 2006) [hereinafter *Petition for Rulemaking*].

447. *Id.* at 9.

448. Petition for Rulemaking, *supra* note 446, at 7.

449. *Id.* at 10.

450. Petition for Rulemaking, *supra* note 446, at 10.

451. *Pacific Gas and Elec. Co. and Southwest Gas Corp.*, 118 F.E.R.C. ¶ 61,005 (2007) [hereinafter *Request for Comments*].

452. *Id.* at P 1.

In particular, the Commission requests that commenters address the following questions:

1. Should the Commission consider lifting the maximum rate cap on a permanent basis either for short-term, or all, capacity releases? Would the factors relied upon in Order No. 637 for lifting the maximum rate cap for short-term releases on an experimental basis support lifting the maximum rate cap today? Do subsequent developments in the natural gas market either lend further support to lifting the maximum rate cap or militate against lifting the cap?
2. Are there methods of providing additional price flexibility for capacity releases short of removing the maximum rate cap, for example through the use of basis differentials to value the capacity or the establishment of seasonally varying maximum capacity release rates?
3. Order No. 636 required that prearranged capacity releases of more than 30 days, which are at less than the maximum rate, be posted for bidding in order to assure that capacity is released to those who value it the most. Should the Commission consider removing this requirement? Does the bidding requirement hinder the negotiation of beneficial release arrangements, and thereby do more harm than good? Would a requirement that the terms of prearranged capacity releases be posted, without requiring bidding, provide sufficient market transparency to discourage undue discrimination in the release of capacity?
4. Does the Order No. 636 prohibition on tying arrangements interfere with beneficial capacity release arrangements, including portfolio management services? Should the Commission clarify or modify its capacity release rules to permit releasing shippers to require replacement shippers to take assignment of the releasing shippers' gas purchase contracts or to take a release of a package of transportation agreements? Should such tying arrangements be permitted only in particular circumstances, such as when a local distribution company is seeking a marketer to manage its gas acquisition activities? Would the risk of undue discrimination be mitigated if the releasing shipper was required to use a formalized request for proposal (RFP) structure with notice of the RFP requirements posted on the pipeline's web site?
5. Should the Commission consider removal of the shipper-must-have-title requirement? While Order No. 637 stated that the capacity release rules were designed with this policy as their foundation, Order No. 637 also recognized that the shipper-must-have-title requirement imposes some transaction costs and that the capacity release program might be revised so that it could operate without that requirement. How could the shipper-must-have-title requirement be removed while still achieving the objective of nondiscriminatory, efficient allocation of released capacity with transparency?<sup>453</sup>

Comments have been filed and this matter is currently pending before the Commission.

*B. Petition for Clarification filed by Coral Energy Resources, LP, Docket Nos. RM91-11-009.*

On October 20, 2006, Coral Energy Resources, LP, Conoco Phillips Company, Chevron U.S.A., Inc., Constellation Energy Commodities Group, Inc., Te-

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453. Request for Comments, *supra* note 451, at P 9.

naska Marketing Ventures, Merrill Lynch Commodities, Inc., Nexen Marketing U.S.A., Inc., and UBS Energy, LLC (collectively, Petitioners) filed a petition for clarification of certain Commission rules and policies relating to the release of capacity on interstate natural gas pipelines.<sup>454</sup> Specifically, Petitioners requested that the Commission “clarify its capacity release rules and policies to provide that:

- prearranged releases of capacity may be made in association with gas supply or purchase arrangements, where the parties freely agree to such a combined transaction and it is referenced in the posting of the release (for informational or bidding purposes, as appropriate), and such releases will not be viewed as involving an improper tying of released capacity to a condition or compensation outside of the release process;
- prearranged releases of capacity may be made on an aggregate basis, on the same pipeline or different pipelines, when the parties freely agree to such a combined transaction and it is referenced in the posting of the release (for informational or bidding purposes, as appropriate), and such releases will not be viewed as involving an improper tying of released capacity to a condition or compensation outside of the release process;
- in the context of a prearranged temporary maximum rate release of capacity under a portfolio management arrangement, the payment of a transaction fee, as a lump sum or as revenues may be earned or in association with gas sales, by the portfolio manager (the replacement shipper) to the portfolio management customer (the releasing shipper) will not be viewed as a payment exceeding the pipeline’s maximum rate; and
- in the context of a prearranged temporary maximum rate release of capacity under a portfolio management arrangement, the payment of reservation charges by the portfolio management customer (the releasing shipper) to the portfolio manager (the replacement shipper) will not cause the release to be biddable.<sup>455</sup>

In the alternative, Petitioners urged the Commission “(i) to expand its recently-adopted no action letter process to include capacity release questions, and (ii) to broaden the types of capacity release transactions that the Commission will address in orders seeking waivers of the Commission’s capacity release rules and policies and related provisions of pipeline tariffs” if the Commission does not issue the clarifications requested by Petitioners.<sup>456</sup>

Petitioners asserted that their request is ripe for Commission action for two reasons. First, the Commission’s recent waiver orders have increased the level of uncertainty relating to capacity release transactions, and second, the Commission’s amplified enforcement power has resulted in increased concerns among market participants about the possible consequences of unintentional violations of Commission capacity release regulations.<sup>457</sup>

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454. Petition for Clarification, *In re Pipeline Serv. Obligations and Revisions to Regulations Governing Self-Implementing Transp.; and Regulation of Natural Gas Pipelines After Wellhead Decontrol*, Docket No. RM91-11-009 (F.E.R.C. Oct. 20, 2006) [hereinafter Petition for Clarification].

455. *Id.* at p. 29-30.

456. Petition for Clarification, *supra* note 454, at 15.

457. *Id.* at 13-14.

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