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SMALL BUSINESS ADMINISTRATION

13 CFR Part 122

Business Loans, Interest Rates

AGENCY: Small Business Administration.

ACTION: Final rule correction.

SUMMARY: On March 11, 1992 the Small Business Administration (SBA) published, in the **Federal Register**, a final rule which allowed for the imposition of higher interest rates for SBA guaranteed loans of $50,000 or less. (57 FR 8573). This correction clarifies the March 11 rule by providing that for variable rate SBA guaranteed loans over $25,000 but not exceeding $50,000 lenders may increase by one percentage point the maximum interest rate described in 13 CFR § 122.8–4 (d), (e), and (f). Further, this correction states that the interest rate on variable rate SBA guaranteed loans for $25,000 or less lenders may increase the interest rate by two percentage points above the maximum rate.

EFFECTIVE DATE: This rule is effective April 10, 1992.

FOR FURTHER INFORMATION CONTACT: Charles R. Hertzberg, Assistant Administrator for Financial Assistance, (202) 205–6490.

SUPPLEMENTARY INFORMATION: On March 18, 1991, SBA published a final rule (56 FR 11354) authorizing lenders of SBA guaranteed loans of $50,000 or less to charge higher interest rates than the maximum authorized under 13 CFR 122.8–4 (d), (e), and (f). This rule was effective through September of 1991. Following an evaluation of the authority, the Agency re-issued the interest rate regulation on March 11, 1992, thus giving it permanent authority (57 FR 8573).

The SBA is hereby amending the language of the March 11, 1992 rule to clarify the monetary ranges for which a loan is eligible for interest rate increases. This clarification is meant to eliminate a possible ambiguity in the language of the rule. It does not alter the substance of the rule as set forth in the regulatory language or described in the preamble to the March 11, 1992 publication. Specifically, SBA is correcting the regulatory language to make clear that variable rate SBA guaranteed loans over $25,000 but not exceeding $50,000 may be increased by one percentage point over the maximum interest rate described in 13 CFR 122.8–4 (d), (e), and (f). A variable rate SBA guaranteed loan of $25,000 or less may be increased by two percentage points over the maximum.

Due to the fact that this rule corrects a previously published final rule and makes no substantive change to the current regulation, SBA is not required to determine if this change constitutes a major rule for purposes of Executive Order 12291, to determine if it has a significant economic impact on a substantial number of small entities pursuant to the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*), or to do a Federalism Assessment pursuant to Executive Order 12612, or to determine if this rule imposes an annual recordkeeping or reporting requirement on 10 or more persons under the Paperwork Reduction Act (44 U.S.C. ch. 35).

List of Subjects in 13 CFR Part 122

Employee benefit plans, Exports, Handicapped, Loan programs—business, Loan programs—veterans, Reporting and recordkeeping requirements, Small businesses.

For the reasons set out in the preamble, part 122, chapter I, title 13, Code of Federal Regulations is amended as follows:

PART 122—BUSINESS LOANS

1. The authority citation for part 122 continues to read as follows:

Authority: 15 U.S.C. 634(b)(6) and 636(a).

2. Section 122.8–4, Variable (fluctuating) rate, is amended by revising paragraph (g) to read as follows:

§ 122.8–4 Variable (fluctuating) rate.

* * * * *

(g) *Higher interest rates for smaller loans.* For a variable rate loan over $25,000 but not exceeding $50,000, the maximum interest rate described above may be increased by one percentage point. For a variable rate loan of $25,000 or less, the maximum interest rate described above may be increased by two percentage points.

* * * * *

(Catalogue of Federal Domestic Assistance Programs No. 59.012, Small Business Loans)

Dated: April 9, 1992.

Patricia Saiki,

Administrator.

[FR Doc. 92–8816 Filed 4–15–92; 8:45 am]

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DEPARTMENT OF ENERGY

Federal Energy Regulatory Commission

18 CFR Part 284

[Docket Nos. RM91–11–000; RM87–34–065; Order No. 636]

Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation; and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol

Issued April 8, 1992.

AGENCY: Federal Energy Regulatory Commission, DOE.

ACTION: Final rule.

SUMMARY: The commission is changing its regulations to restructure the services provided by interstate natural gas pipelines. The changes are intended to ensure that transportation service is equal in quality for all gas supplies, whether the customer purchases the gas from the pipeline or from another supplier. This should maximize the consumer benefits of the competitive wellhead gas market by allowing buyers of natural gas to reach as many sellers as possible, thereby ensuring that the most efficient and beneficial transactions take place.

EFFECTIVE DATE: This rule will become effective May 18, 1992.

FOR FURTHER INFORMATION CONTACT: Jeffrey A. Braunstein, Office of the General Counsel, Federal Energy Regulatory Commission, 825 North Capitol Street, NE., Washington, DC 20426, (202) 208–2114.

SUPPLEMENTARY INFORMATION: In addition to publishing the full text of this

document in the **Federal Register**, the Commission also provides all interested persons an opportunity to inspect or copy the contents of this document during normal business hours in room 3104, 941 North Capitol Street, NE., Washington, DC 20426.

The Commission Issuance Posting System (CIPS), an electronic bulletin board service, provides access to the texts of formal documents issued by the Commission. CIPS is available at no charge to the user and may be accessed using a personal computer with a modem by dialing (202) 208–1397. To access CIPS, set your communications software to use 300, 1200, or 2400 baud, full duplex, no parity, 8 data bits, and 1 stop bit. The full text of this final rule will be available on CIPS for 30 days from the date of issuance. The complete text on diskette in WordPerfect format may also be purchased from the Commission's copy contractor, La Dorn Systems Corporation, also located in room 3104, 941 North Capitol Street, NE., Washington, DC 20426.

TABLE OF CONTENTS

I. Introduction
II. Public Reporting Requirements
III. The Commission's Goals in Adopting this Rule
IV. Background
V. The Anticompetitive Effect of the Current Regulatory Environment and Pipeline Services
VI. The Remedy
A. The Remedy Proposed in the NOPR
B. Comments on the NOPR
C. Remedial Action in the Final Rule
VII. Essential Aspects of, and Terms and Conditions for, Open Access Transportation
A. Introduction
B. Transportation Equality and Other Principles
C. Capacity Reallocation
1. Upstream Pipeline Capacity
2. Voluntary Reallocation of Firm Transportation Capacity
D. "No-Notice" Transportation Service
E. Storage
F. Market Centers and Pooling Areas
1. Market Centers
2. Pooling Areas
G. Flexible Receipt and Delivery Points
H. Curtailment
VIII. Rate Design
A. Introduction
B. Background
C. Comments on the NOPR's Proposal
E. Discussion of Comments
1. Mitigation of Cost Shifts
2. Pipeline Incentives
3. Gas Purchase Decisions
IX. Pipeline Sales
A. Blanket Sales Certificates
B. Pricing
C. Blanket Interruptible Sales Service
D. Standards of Conduct
E. Reporting Requirements
X. Pipeline Service Obligations (After Restructuring Proceedings)
A. Introduction
B. Overview of Final Rule
C. Interruptible Transportation and Short-Term Firm Transportation Service
D. Unbundled Sales Service
E. Long-Term Firm Transportation
1. Comments on the NOPR
2. The Right of First Refusal
a. Rate Requirement
b. Contract Term
c. Mechanics of the Process—Post-Restructuring Proceedings
d. Bona Fide Offers
e. Offers for a Portion of Existing Customer's Capacity
f. Converted Sales
XI. Transition and Implementation in the Restructuring Proceedings
A. Adjustment of Purchase Obligations and Firm Capacity
1. The Need for Adjustments
2. Discussion of Comments
B. Transition Costs and Recovery Mechanisms
1. Summary and Rationale
2. Discussion of Comments
3. Grant Plains Gas
C. Schedule and Procedures
1. Summary
2. Discussion
3. Other Matters
XII. Environmental Analysis
XIII. Regulatory Flexibility Certification
XIV. Information Collection
XV. Effective Date
Regulatory Text

Before Commissioners: Martin L. Allday, Chairman; Charles A. Trabandt, Elizabeth Anne Moler, Jerry J. Langdon and Branko Terzic.

I. Introduction

By adopting the proposed rule with modifications, this rule requires significant alterations in the structure of interstate natural gas pipeline services in light of the changes in the natural gas industry brought about by the Natural Gas Policy Act of 1978 (NGPA),[1] the Commission's open access transportation program,[2] and the Natural Gas Wellhead Decontrol Act of 1989 (Decontrol Act).[3] The Commission believes that this rule, when fully implemented, will finalize the structural changes in the Commission's regulation of the natural gas industry. This rule will therefore reflect and finally complete the evolution to competition in the natural gas industry initiated by those changes [4] so that all natural gas suppliers, including the pipeline as merchant, will compete for gas purchasers on an equal footing. As discussed below, this promotion of competition among gas suppliers will benefit all gas consumers and the nation by "ensur[ing] an adequate and reliable supply of [clean and abundant] natural gas at the lowest reasonable price." [5]

II. Public Reporting Requirements

The Commission estimates the public reporting burden as a result of this rule to be an average of 4,810 hours per response for FERC–545, 2.7 hours for FERC–549 and 9.94 hours for FERC–592. The annual reporting burden associated with this rule is estimated to be 428,090 hours for FERC–545, 410 hours for FERC–549, and 885.2 hours for FERC–592 for a total of 429,385.2 hours. The estimate includes time for reviewing the requirements adopted by this rule, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information and filing this information with the Commission. Most of the burden hours (428,090 hours under FERC–545) are related to a one-time implementation tariff filing requirement. Interested persons may send comments regarding these burden estimates or other aspects of these collections of information, including suggestions for reducing this burden, to the Federal Energy Regulatory Commission, 825 N. Capitol Street, NE., Washington, DC 20426 [Attention: Michael Miller, (202) 208–1415]; and to the Office of Management and Budget, Washington, DC 20503 [Attention: Desk Officer for the Federal Energy Regulatory Commission].

III. The Commission's Goals in Adopting This Rule

The Commission's responsibility under the Natural Gas Act (NGA) [6] is to

[1] 15 U.S.C. 3301–3432 (1988).

[2] Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, Order No. 436, 50 FR 42408 (Oct. 18, 1985), FERC Stats. & Regs. [Regulations Preambles 1982–1985] ¶ 30,665 (1985), vacated and remanded, *Associated Gas Distributors* v. *FERC*, 824 F.2d 981 (D.C. Cir. 1987), cert. denied, 485 U.S. 1006 (1988), readopted on an interim basis, Order No. 500, 52 FR 30334 (Aug. 14, 1987), FERC Stats. & Regs. [Regulations Preambles, 1986–1990] ¶ 30,761 (1987), remanded, *American Gas Association* v. *FERC*, 888 F.2d 136 (D.C. Cir. 1989), readopted, Order No. 500–H, 54 FR 52344 (Dec. 21, 1989), FERC Stats. & Regs. [Regulations Preambles 1986–1990] ¶ 30,867 (1989), reh'g granted in part and denied in part, Order No. 500–I, 55 FR 6605 (Feb. 26, 1990), FERC Stats. & Regs. [Regulations Preambles 1986–1990] ¶ 30,880 (1990), aff'd in part and remanded in part, *American Gas Association* v. *FERC*, 912 F.2d 1496 (D.C. Cir. 1990), cert. denied, 111 S. Ct. 957 (1991).

[3] Public Law No. 101–60, 103 Stat. 157 (1989).

[4] Those changes are discussed in detail, *infra*.

[5] S. Rep. No. 39, 101st Cong., 1st Sess., at p. 1 (1989) and H.R. Rep. No. 29, 101st Cong., 1st Sess., at p. 2 (1989).

[6] 15 U.S.C. 717–717w (1988).

protect the consumers of natural gas from the exercise of monopoly power by pipelines [7] in order to ensure consumers "access to an adequate supply of gas at a reasonable price." [8] This mission must be undertaken by balancing the interests of the investors in the pipeline, to be compensated for the risks they have assumed, and the interests of consumers,[9] and in the light of current economic, regulatory, and market realities. Hence, the Commission must fulfill its NGA mandate in the context of the decontrolled gas commodity market, the competition among gas merchants (including pipelines) for gas sales to local distribution companies (LDCs) and end users, such as industrials and gas-fired electric generators, and continued pipeline market power over transportation. In addition, the Commission's goal here is informed by Congress' urging, when it enacted the Decontrol Act, that the Commission "improve [the] competitive structure [of the natural gas industry] in order to maximize the benefits of [wellhead] decontrol." [10]

At the same time, the Commission recognizes that the natural gas industry has undergone significant changes in the past ten years. Historically, pipelines have served as gas merchants—buying gas at the wellhead and selling it at the city gate to LDCs. This bundle sales service was reliable and suited the regulatory and commercial situation then prevailing in the gas industry. Indeed, until recently, there was little, if any, competition between gas suppliers in the natural gas industry.

The Commission has recognized the movement to competition set in motion by the NGPA in 1978. From the special marketing programs in 1984, to the elimination of pipeline minimum bills, to Order Nos. 436 and 500, the Commission has sought to promote and expand access to the wellhead market. Now, the complete deregulation of the wellhead market is on the horizon. The Commission must, therefore, take further steps to ensure that the public can realize the full benefits of the competition at the wellhead.

Since the issuance of Order No. 436, the Commission's efforts to adopt a more competitive gas market have been hindered. Non-pipeline sellers have correctly argued that the transportation of their gas supplies is not comparable to the transportation embedded in a pipeline's sales service, particularly during peak periods. This hinders their ability to sell gas on a long-term basis. On the other hand, pipelines have argued that existing transportation service cannot be improved since they must retain capacity to meet LDCs' existing certificated sales levels and fulfill their NGA section 7(c) service obligations. At the same time LDCs have argued that they cannot convert existing certificated firm sales service to transportation because that transportation may not be as reliable as existing pipeline bundled sales service during peak periods. In addition, LDCs have been concerned that transportation capacity will be abandoned at the end of the contract term, should they convert from firm sales to firm transportation.

This rule addresses all of those issues. First, the Commission is taking steps to equalize the transportation of gas sold by pipelines and nonpipeline sellers. Second, the Commission is providing a means to recover all of the costs of restructuring existing non-market sensitive gas supply contracts. Finally, the Commission is providing for a "no-notice" transportation service in response to those who have expressed a particular concern about reliability during peak periods. In addition, the Commission is responding to concerns about pregranted abandonment for transportation services at the end of the contract term.

The Commission must create a regulatory environment in which no gas seller has a competitive advantage over another gas seller. In particular, the Commission must regulate the pipeline transportation system and ensures that pipeline sales for resale in a manner that pipeline control of the transportation system—a natural monopoly—does not give a competitive advantage to pipelines over other sellers in the sale of natural gas. This will ensure that the benefits of decontrol redound to the consumers of natural gas to the maximum extent as envisioned by the NGPA and the Decontrol Act.[11]

The Commission's primary aim in adopting the instant regulations is to improve the competitive structure of the natural gas industry and at the same time maintain an adequate and reliable service. The Commission will do this by regulating pipelines as merchants and as open access transporters in a manner that accomplishes two fundamental goals. The first goal is to ensure that all shippers have meaningful access to the pipeline transportation grid so that willing buyers and sellers can meet in a competitive, national market to transact the most efficient deals possible. As the House Committee Report to the Decontrol Act stated: "All sellers must be able to reasonably reach the highest-bidding buyer in an increasingly national market. All buyers must be free to reach the lowest-selling producer, and obtain shipment of its gas to them on even terms with other supplies."[12]

The Commission's second fundamental goal is to accomplish the first goal in a way that continues to ensure consumers "access to an adequate supply of gas at a reasonable price." [13] The Commission will act in a way that harmonizes both goals and thereby promotes competition and protects gas consumers. The Commission's intent is to further "facilitat[e] the unimpeded operation of market forces to stimulate the production of natural gas * * * [and thereby] contribute to reducing our Nation's dependence upon imported oil, help to ensure the availability of clean-burning natural gas for purposes of addressing environmental problems and the need for electric generating capacity[.]" [14]

The Commission believes that to accomplish those objectives it is vital to give all gas purchasers (LDCs and end users, such as industrials and gas-fired electric generators) the ability to make market-driven choices about the price of gas as a commodity and about the cost of delivering the gas. Simply put, efficiency in the now national gas market can be realized only when the purchasers of a commodity know, in a timely manner, the prices of the distinct elements associated with the full range of services needed to purchase and then deliver gas from the wellhead to the burnertip. Only then will gas purchasers be able to purchase, based upon their needs, the exact services they want with full recognition of the prices that they would have to pay. And only then will the Commission be assured that all gas is transported to the market place on fair terms. What best serves the interests of gas purchasers—the ability

[7] *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 610 (1944); *Associated Gas Distributors* v. *FERC*, 824 F.2d 981, 995 (D.C. Cir. 1987), cert. denied, 485 U.S. 1006 (1988) ("The Natural Gas Act has the fundamental purpose of protecting interstate gas consumers from pipelines' monopoly power.")

[8] *Tejas Power Corp.* v. *FERC*, 908 F.2d 998, 1003 (D.C. Cir. 1990).

[9] *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944). ("The rate-making process under the [NGA] . . . involves a balancing of the investor and consumer interests.").

[10] H.R. Rep. No. 29, *supra*, at p. 6.

[11] "Repeal of the remaining wellhead controls will promote the unimpeded transmission of market signals from burnertip to wellhead and thereby help to ensure adequate supplies of reasonably priced natural gas in the future." S. Rep. No. 39, *supra*, at p. 2.

[12] H.R. Rep. No. 29, *supra*, at p. 6.

[13] Tejas, *supra*, at 1003; H.R. Rep. No. 29, *supra*, at p. 2.

[14] S. Rep. No. 39, *supra*, at p. 2.

to make informed choices—is also important for gas sellers. Nonpipeline sellers also need to know the prices of the distinct elements of pipeline services in order to price their product and to decide the exact pipeline services needed to bring their gas to market. This rule provides both gas purchasers and gas sellers with the ability to make the necessary informed choices.

The Commission is adopting the major elements of the proposed rule, as modified below. In brief, this rule requires pipelines to unbundle (*i.e.*, separate) their sales services from their transportation services at an upstream point near the production area and to provide all transportation services on a basis that is equal in quality for all gas supplies whether purchased from the pipeline or from any other gas supplier. This rule issues blanket sales certificates to pipelines so that they can offer unbundled firm and interruptible sales services at market-based rates. In addition, pipelines will be required to provide a variety of transportation services to their shippers. This includes a new unbundled "no-notice", firm transportation service, firm transportation service that is unbundled and improved in quality, unbundled storage services, and interruptible transportation services, among others. As stated above, this will permit gas purchasers and gas sellers to choose the exact transportation service that they want, including a combination of services that will ensure that the pipelines can deliver an adequate supply of gas to the city gate from various sources when that supply is needed.

This rule also amends § 284.221(d) of the Commission's Regulations [15] in further response to the remand of the United States Court of Appeals for the District of Columbia Circuit in *American Gas Association* v. *FERC*, 912 F.2d 1496 (D.C. Cir. 1990), *cert. denied*, 111 S. Ct. 957 (1991) (*AGA II*).[16] The amendment to § 284.221(d) would allow pregranted abandonment for interruptible and short-term (one year or less) firm transportation, and for long term (over one year) firm transportation under certain conditions. In addition, this rule adopts the straight fixed variable method for rate design, unless the Commission provides otherwise. Finally, this restructuring rule modifies the terms of existing capacity brokering programs to conform to a generic capacity releasing program that incorporates many features of capacity brokering while addressing concerns about the discriminatory allocation of pipeline capacity.

IV. Background

A brief history of the natural gas industry and its regulation puts the instant rulemaking in historical perspective, and shows that the rule is a logical outgrowth of the changes in both the industry and its regulation as they have evolved over the last fifty plus years.

In 1938, Congress enacted the NGA to regulate the sale for resale in interstate commerce of natural gas.[17] Congress' action stemmed from the Supreme Court's barring of state regulation of wholesales of natural gas [18] and from a 1935 report of the Federal Trade Commission (FTC).[19] The FTC report specifically referred to the "[u]nregulated control of pipe-line transmission and of wholesale distribution" as a "positive evil." [20] The FTC report described the significance of control over the pipelines as follows:

> Whoever controls the channels by which a product is marketed controls the market so far as the supply is concerned. Concentrated control of those channels confers a strategic advantage that may be used by those possessing it to extend their domination into both the producing and distributing branches of the industry.[21]

In that light, Congress enacted the NGA because it "considered that the natural gas industry was heavily concentrated and that monopolistic forces were distorting the market price for natural gas." [22] Congress' "primary aim * * * was to protect consumers against exploitation at the hands of natural gas companies" [23] to ensure consumers "access to an adequate supply of gas at a reasonable price." [24] Congress, therefore, regulated the interstate chain of distribution of natural gas from the wellhead to market under a public utility model.[25] The "heart of the new regulatory system" was the "fixing of 'just and reasonable' rates" [26] for natural gas companies (both producers and pipelines) engaging in the sale for resale in interstate commerce of natural gas.[27] The structure of the natural gas industry regulated by the NGA was simple. The producers would sell their natural gas in the production area to the interstate pipelines at Commission-determined just and reasonable rates. The pipelines would transport their purchased gas and their own production to the city gate for sale to local distribution companies (LDCs) at Commission-determined just and reasonable rates which recovered both the pipelines' cost of gas and cost of transmission. In addition, the pipelines would sell gas to end users in nonjurisdictional sales with an appropriate allocation of costs to the nonjurisdictional services.[28] Producer sales to LDCs or end users in the production area, with the pipeline providing only the transportation, were rare. The central features of the NGA-regulated natural gas industry were Commission-determined just and reasonable prices and interstate pipeline sales of gas for resale to LDCs at the city gate at those prices in transactions that combined or bundled into one package the pipelines' gas supply and transmission costs.

The interstate natural gas shortages of the 1970s were the catalyst for reform of the regulation of the natural gas industry. Simply put, the Commission's struggles with producer rates did not prove adequate to the task of ensuring an adequate supply of interstate gas.[29] Hence, Congress responded to the natural gas shortages by enacting the NGPA to increase the flow of gas into the interstate market.

The NGPA created new statutory rates for the wholesale gas market, for so-called "first sales" of natural gas, in lieu of rates established by the Commission. Those new rates were "intended to provide investors with

[15] 18 CFR 284.221(d).

[16] As discussed below, on February 13, 1991, the Commission's initial response to the AGA II remand was to issue an order staying in part § 284.221(d). Natural Gas Pipelines After Partial Wellhead Decontrol, 56 FR 6962 (Feb. 21, 1991); III FERC Stats. & Regs. ¶ 30,915 (Feb. 13, 1991) (Order No. 500-J).

[17] 15 U.S.C. 717–717w (1988).

[18] See, *e.g.*, *Peoples Natural Gas Co.* v. *Public Service Commission of Pennsylvania*, 270 U.S. 550 (1926).

[19] Final Report of the Federal Trade Commission to the Senate of the United States pursuant to S. Res. 83, 70th Cong., 1st Sess. (1935).

[20] *Id.* at 615.

[21] *Id.* at 591.

[22] *FPC* v. *Texaco, Inc.*, 417 U.S. 380, 397–398 (1974).

[23] *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 610 (1944).

[24] Tejas, *supra*, at 1003.

[25] *Mobil Oil Corp.* v. *FPC*, 417 U.S. 283, 302–03 n.23 (1974).

[26] *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 611 (1944).

[27] In *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954), the Supreme Court held that the just and reasonable rate prescription of the NGA applied to the rates of gas producers. See also the discussion of producer regulation under the NGA in *Public Service Commission of the State of New York* v. *Mid-Louisiana Gas Co.*, 463 U.S. 319, 327–331 (1983).

[28] See, *e.g.*, *Colorado Interstate Gas Co.* v. *FPC*, 324 U.S. 581 (1945).

[29] See *Public Service Commission of the State of New York* v. *Mid-Louisiana Gas Co.*, 463 U.S. 319, 330–31 (1983). Commission established prices for gas in the interstate market could not compete with prices available in the intrastate markets where the prices were not regulated.

adequate incentives to develop new sources of supply." [30]

As part of the new rate structure, the NGPA also started the process of decontrolling wellhead prices of natural gas. Upon decontrol, NGPA Section 601 removed much of the pricing of the nation's natural gas supplies from the Commission's regulatory jurisdiction.[31] In addition, the NGPA, in section 311, broke down the existing barriers between intrastate and interstate markets for natural gas. In that vein, Congress took action to promote gas transportation by interstate and intrastate pipelines by authorizing the Commission to approve certain transportation arrangments outside of the NGA's certification requirements.[32] For example, NGPA section 311(a)(1) authorized the Commission to approve the transportation of gas by an interstate pipeline on behalf of any intrastate pipeline and any LDC. In sum, the NGPA's aim was to permit a competitive wellhead market where market forces play a "more significant role in determining the supply, the demand, and the price of natural gas." [33]

The NGPA, therefore, radically changed a key aspect of the natural gas industry by eliminating Commission-determined prices for first sales of natural gas. In doing that, the NGPA "reflect[ed] the workably competitive nature of the production industry." [34] Moreover, the NGPA accelerated a fundamental change in the natural gas industry—"natural gas * * * [became] a separate and distinct economic *commodity:* distinct from oil, distinct from transportation, and distinct from storage and various load balancing services." [35]

In 1985, the Commission adopted Order No. 436 [36] in response to the NGPA's aim to permit a more competitive wellhead market and to the economic changes in the natural gas industry.[37] Order No. 436 instituted open-access, non-discriminatory transportation to permit downstream gas users such as LDCs and industrials to buy gas directly from gas merchants in the product area and to ship that gas via the interstate pipelines.

To achieve open access transportation, Order No. 436 adopted three key regulations that are pertinent here. First, pipelines were required to permit their firm sales customers to convert their firm sales entitlements to a volumetrically equivalent amount of firm transportation service over a five-year period.[38] Second, the pipelines were required to offer their open-access transportation services without discrimination or preference.[39] Third, the pipelines were required to design maximum rates to ration capacity during peak periods and to maximize throughput for firm service during offpeak periods and for interruptible service during all periods.[40] Order No. 436 thus provided the downstream gas purchasers with an alternative to buying gas from the pipelines in the distribution area under the pipelines' bundled sales services.

Order No. 436's open-access transportation program has accomplished, in part, its goals of increasing competition and treating the sale of gas and the transportation of gas as separate economic transactions. Two facts attest to the considerable success of Order No. 436. First, an active and viable spot market has developed for gas.[41] Second, the role of pipelines has changed from primarily merchants of natural gas in the distribution area to both merchants of natural gas and nondiscriminatory transporters of natural gas owned by others.

Indeed, pipeline transportation now accounts for about 79 percent of total annual interstate pipeline throughput.[42] This reverses the historical function of pipelines, which prior to Order No. 436 acted primarily as gas merchants.[43] Today, gas transported on behalf of non-pipeline shippers plays a major role in providing service to customers, including service during the winter heating season.[44] The active spot market and significant pipeline transportation of gas owned by others illustrate that pipelines and other gas merchants, such as producers and marketers, are vigorously competing in the sale of gas to LDCs and other end users.

To repeat, the NGPA and Order No. 436 fundamentally changed two key components of the natural gas industry. First, the price of natural gas as a commodity was no longer subject to Commission-determined rates. Second, the transportation and sale of natural gas became distinct economic and commercial services. In that manner, pipelines and other gas merchants have become direct competitors in the sale of gas to LDCs and to end users, such as industrials or gas-fired electric generators.

In 1989, Congress built upon the significant changes in the natural gas industry shaped by the NGPA and Order No. 436 by enacting the Decontrol Act. [45] This legislation amended the NGPA "to repeal all remaining price controls on wellhead or 'field' sales of natural gas" [46] in order to obtain "more abundant [gas] supplies" at "lower prices" by creating competition among a "set of efficient producers." [47] The House Committee Report stated that the Commission's "current competitive 'open access' pipeline system [should be] maintained" and further described

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[30] *Id.* at 334. In the NGPA, Congress eliminated this distinction between the interstate and intrastate gas markets.

[31] See *Pennzoil Co.* v. *FERC*, 645 F.2d 360, 380–383 (5th Cir. 1981), *cert. denied*, 454 U.S. 1142 (1982); Associated Gas Distributors v. FERC, 824 F.2d 981, 1001 (D.C. Cir. 1987), *cert. denied*, 485 U.S. 1006 (1988); See also Order No. 500–H, supra n.2, FERC Stats. & Regs. [Regulations Preambles 1986–1990] ¶ 30,867 at p. 31,537–40 (1989).

[32] Section 601(a)(2)(A) of the NGPA provides that the Commission does not have NGA Section 1(b) jurisdiction over NGPA Section 311 transportation.

[33] *Transcontinental Gas Pipe Line Corp.* v. *State Oil and Gas Board of Miss.*, 474 U.S. 409, 422 (1986).

[34] Order No. 436, *supra* n.2 at p. 31,470. See also *Pennzoil* Co v. *FERC*, 645 F.2d 360, 378–79 (5th Cir. 1981), *cert. denied*, 454 U.S. 1142 (1982).

[35] *Id.* at pp. 31,472–73 (emphasis in original).

[36] See n.2, *supra*.

[37] See the discussion in Order No. 433, *supra* n.2 at pp. 31,469–70 and 31,472–74.

[38] 18 CFR 284.10.

[39] 18 CFR 284.8(b) and 284.9(b). The pipelines could impose reasonable operational conditions to effectively manage their systems. 18 CFR 284.8(c) and 284.9)(c).

[40] 18 CFR 284.7(c) (1) and (2).

[41] See the Commission staff study in Interim Gas Supply Charges and Interim Gas Inventory Charges, Notice of Proposed Policy Statement, "Use of Spot Market Prices for Sales Service and Gas Inventory Charges", 47 FERC ¶ 61,294 Appendix at pp. 62,036–62,040 (1989) ("Staff concludes that the spot market is a well functioning market in the sense that it is broad and that prices do indicate its responsiveness to supply and demand[.]" *Id.* at p. 62,036).

[42] Energy Information Administration/Natural Gas Monthly (Feb., 1992); DOE/EIA–0130 (92/02), From: Table 15. Natural and Other Gases Produced and Purchased by Major Interstate Natural Gases Pipeline Companies, 1985–1991 (around 80 percent transportation); Interstate Natural Gas Association of America, Issue Analysis: Carriage Through 1990 (July 1991), From: Table A–1, Carriage for Distributors, End-Users, and Marketers and Sales Summary (79 percent transportation) (INGAA July 1991 paper). The updated INGAA paper shows transportation at 83 percent for the first half of 1991. Interstate Natural Gas Association of America, Issue Analysis: Carriage Through the First Half of 1991 (November 1991), From: Table A–1 Carriage for Distributors, End-Users, and Marketers and Sales Summary (INGAA November 1991 paper).

[43] In 1984, transportation amounted to 8 percent of the total gas carried to market by pipelines. INGAA November 1991 paper, *supra*, Table A–1.

[44] In the First quarter of 1990, sales gas amounted to 29 percent of total carriage delivered to market. In the first quarter of 1991, that figure was 21 percent. The remainder was gas carried to market for LDCs, for end users and for marketers. INGAA November 1991 paper, *supra*, Table A–1.

[45] Pub. L. No. 101–60, 103 Stat. 157 (1989).

[46] H.R. Rep. No. 29 *supra*, at p. 2.

[47] *Id.* at 7.

the importance of open access transportation as follows:

The Committee stresses that these new rules, and especially the wide adoption of blanket certificates for non-discriminatory open access interstate transportation of non-pipeline gas, are essential to its decision to complete the decontrol process. All sellers must be able to reasonably reach the highest-bidding buyer in an increasingly national market. All buyers must be free to reach the lowest-selling producer, and obtain shipment of its gas to them on even terms with other supplies.[48]

The House Committee Report further urged the Commission "to retain and *improve* this competitive structure in order to maximize the benefits of decontrol." [49]

The Decontrol Act did not, however, alter the NGA's consumer protection mandate. Indeed, the House Committee Report stated:

Though not protected by remaining wellhead controls, consumers still have a stake in how FERC handles gas pipeline transportation issues and allocates gas costs. This legislation does not deregulate gas pipelines * * *.[50]

Similarly, the Senate Committee Report stated that "the purpose [of the legislation] is to promote competition for natural gas at the wellhead in order to ensure consumers an adequate and reliable supply of natural gas at the lowest reasonable price."[51] In addition, the Senate Report stated:

While this bill decontrols the first sale of natural gas, it does not deregulate interstate natural gas pipelines. The term "first sale", as defined by section 2(21) of the NGPA, expressly excludes "the sale of any volume of natural gas by any interstate pipeline." A pipeline's obligation to serve its customers arises out of the Natural Gas Act and is not affected by the decontrol of first sale transactions under the NGPA.[52]

To sum up, in the evolution of the natural gas industry from passage of the NGA in 1938 to the passage of the Decontrol Act, the industry has been transformed from the "traditional" structure where "pipelines purchased gas from producers [at regulated prices] and transported that gas to consuming markets where it was resold to LDCs [at regulated prices] and end users" [53] to a new structure where "LDCs and industrial end users increasingly have utilized pipelines only to transport [at regulated rates] the gas that they purchase [at decontrolled prices] directly from producers and markets." [54] Indeed, as stated above, the role of natural gas pipelines has changed significantly, since pipeline transportation services now account for 79 percent of pipeline throughout.[55] This is a significant reversal from the pipelines' pre-Order No. 436 primary role as merchants of a bundled sales service.

Hence, at present, pipelines compete with other sellers of natural gas for sales to LDCs and end users, such as industrials and gas-fired electric generators. However, under the present regulatory structure of the natural gas industry, those competitors move their gas through the pipeline network using mainly interruptible transportation service, which amounted to 51 percent of deliveries for market in 1990.[56] Most pipelines, on the other hand, sell their gas in the distribution area on a firm basis and, therefore, use the firm transportation embedded within their bundled, firm sales service to move their gas. The interruptible transportation used to move much of the gas competing with pipeline gas is, by definition, inferior to the firm transportation included within the bundled, firm sales service.

In addition, although competitors moved their gas through the pipeline network in 1990 using firm transportation amounting to 28 percent of total deliveries for market,[57] this firm transportation, as discussed below, is inferior in quality to the firm transportation embedded within the pipelines' bundled, city-gate, firm sales service. Simply put, the latter service has access to essential facilities and services, such as storage, that are not generally available to shippers currently using firm transportation. Hence, the natural gas industry has not completed its evolution to the point where all gas is shipped on even terms without regard to the identity of the supplier.

V. The Anticompetitive Effect of the Current Regulatory Environment and Pipeline Services

The fundamental issue before the Commission is whether the current regulatory structure provides all gas sellers with the same opportunity to compete for gas purchasers. The Commission must examine the current pipeline sales services and firm and interruptible transportation services as well as its regulatory methods to determine whether they operate to give competitive advantages and disadvantages to the various participants in the natural gas industry. If the Commission concludes that its current regulatory structure and the current form of bundled pipeline services are unduly discriminatory and anticompetitive, and therefore unlawful under NGA Section 5,[58] it *must* fashion a remedy that corrects the undue discrimination.[59]

This remedial action must not undermine the quality or reliability of services received by the pipeline customers. For, as discussed below, it is vital that pipeline customers continue to have access to an adequate and reliable supply of gas when needed to meet the needs of gas consumers at all times.

In 1990, although 21 percent of pipeline deliveries to market were pipeline sales as opposed to transportation of gas,[60] a disproportionate amount of pipeline capacity was reserved for pipeline firm sales services. This is attested to by the fact that, in 1990, 51 percent of the pipeline deliveries to market used interruptible transportation.[61] This considerable movement of gas by interruptible transportation shows that firm sales customers have not converted their firm sales entitlements to firm transportation service. According to INGAA, "[c]onversions of maximum daily quantity (MDQ) rights amounted to slightly over 24 percent, or 8.5 Bcf/day, for the * * * period (1988–1990)." [62]

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[48] *Id.* at 6.

[49] *Id.* (Emphasis added).

[50] *Id.* at 4.

[51] S. Rep. No. 39, *supra*, at p. 1.

[52] *Id.* at 9

[53] *Id.* at 6.

[54] *Id.*

[55] INGAA November 1991 paper, *supra*, Table A-1.

[56] INGAA November 1991 paper, *supra*., Table A-6. Sales and Firm and Interruptible Transportation as a Percentage of Total Deliveries for Market through First Half 1991. In the first half of 1991, interruptible transportation amounted to 52 percent of total deliveries for market. *Id.*

[57] *Id.* In the first half of 1991, firm transportation amounted to 31 percent of total deliveries for market. *Id.*

[58] NGA section 5(a) provides in pertinent part that:

"Whenever the Commission, after a hearing had upon its own motion or upon complaint of any state, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order * * *."

[59] *Office of Consumers' Counsel* .v. *FERC*, 783 F.2d 206, 236 (D.C. Cir. 1986).

[60] INGAA November 1991 paper, *supra*, Table A-1. Table 1 to this order sets forth pipeline "Sales Share as a percent of Total Gas Delivered for Market" from 1984–1991. Most of the sales were firm sales.

[61] INGAA November 1991 paper, *supra*, Table A-6. The remaining 28 percent of the throughput was firm transportation.

[62] INGAA July 1991 paper, *supra*, at p. 3. INGAA further stated that "[o]f the 22 responding pipelines,

Continued

This is confirmed by the pipeline capacity reports filed with the Commission under § 284.12 of the regulations. The 1991 Capacity Reports for major pipelines that made bundled sales show that over 60 percent of peak day capacity on major pipelines was reserved for pipeline firm sales service. This is shown by table 2 below. For those same pipelines, as shown in Table 3, 1990–91 pipeline sales accounted for only 18.8 percent of total throughput.

TABLE 1.—SALES SHARE AS A PERCENT OF TOTAL GAS DELIVERED TO MARKET

Year	Q1	Q2	Q3	Q4
1984	94	91	90	91
1985	90	84	77	78
1986	77	59	49	58
1987	58	33	38	43
1988	51	27	27	37
1989	37	21	21	35
1990	29	17	15	22
1991	21	12	N.A.	N.A.

N.A.= Not Available.

Source: INGAA, *Issue Analysis:* Carriage Through the First Half of 1991 (November 1991), Table A-1.

Table 2.—Capecity Reserved From 1991 Capacity Reports

Pipeline	Capacity (MMcf or Mdth)			Sales capacity as a percent of total capacity
	Sales	Firm Transport	Total	
ANR	2,395	2,744	5,139	46.6
CIG	986	709	1,695	58.2
Columbia	4,562	1,141	5,703	80.0
MRT	876	56	932	94.0
National Fuel	1,203	535	1,738	69.2
Natural	2,280	1,173	3,453	66.0
Panhandle	1,051	1,513	2,564	41.0
Southern	1,888	291	2,179	86.6
TETCO	2,398	1,345	3,743	64.1
Trunkline	689	909	1,598	43.1
Williams	1,736	243	1,979	87.7
CNG [1]	2,662	1,215	3,877	68.7
Florida Gas [1]	316	603	919	34.4
Tennessee [2]	2,230	2,683	4,913	45.4
Texas Gas [1]	1,975	475	2,450	80.6
United [1]	855	575	1,430	59.8
Average				64.1

[1] Based on Recent Rate Case CD Levels (Respectively RP90-143, RP91-187 & CP91-2448, RP90-104, and RP91-126).

[2] Assumes Settlement in Docket No. RP86-119, *et al.*, is in effect.

While pipeline sales were less than 20 percent of total throughput on the major pipelines, during the three day period of peak usage, pipeline sales were approximately 50 percent of total deliveries (see Table 3). The seasonal nature of the pipeline sales indicates that customers rely on pipeline sales during periods when capacity is most likely to be constrained. For example, as Table 3 shows, approximately 85 percent of the sales by Tennessee Gas Pipeline Company and Williams Natural Gas Company occurred during the winter months. On many other pipelines 70 percent or more of their sales were made during the winter season, and overall approximately 65 percent of pipeline sales were made in the winter months. This is illustrated in table 3.

TABLE 3

Pipeline	Sales as a percent of total throughput [1]	Sales as a percent of 3-day peak [2]	Winter sales as a percent of total sales [3]
ANR	11.2	43.9	72.4
CIG	19.8	51.7	61.9
CNG	31.2	85.1	74.1
Columbia	10.6	50.4	21.7
Florida Gas	18.5	41.1	54.1
MRT	33.2	99.1	76.2
National Fuel	52.2	73.3	70.4
Natural	18.5	N.A.	47.4
Panhandle	10.6	27.1	71.6
Southern	20.5	62.3	72.5
Tennessee	4.0	13.8	65.1
TETCO	18.8	58.8	75.1
Texas Gas	12.7	59.7	66.9
Trunkline	15.3	27.7	43.2
United	1.8	44.5	73.8
Williams	20.3	45.7	83.9
Average	18.8	52.4	65.8

N.A. Not available.

[1] FERC Form 11, Nov. 90–Oct. 91.

[2] Filed rate cases (Respectively RP89-161, RP90-69, RP90-143, RP91-161, RP91-187 & CP91-2448, RP89-248, RP92-73, RP91-229, RP92-134, RP91-203, RP90-119, RP90-104, RP89-160, RP91-126, and RP91-152).

[3] FERC Form 11, Nov. 90–Oct. 91.

The result is that while a large portion of pipeline capacity is reserved for firm sales, pipeline sales customers prefer to buy their gas from other sellers and have it transported using interruptible transportation. However, during peak winter periods pipeline sales predominate over sales by other gas sellers. The result is an inefficient market that disadvantages all segments of the gas industry as discussed further below.

Gas buyers are disadvantaged because they are paying the demand charges for firm pipeline sales service, and, in addition, paying the interruptible rates to transport gas purchased from other sellers. Instead of buying gas from the pipeline or converting to firm transportation, gas buyers are choosing to purchase gas from nonpipeline merchants and transporting the gas to market using an inferior form of transportation. As shown in Table 4, the price of pipeline gas generally has been 20 to 80 cents higher per Mcf than the price available from other sellers. Thus, it is often cheaper for pipeline sales customers to buy gas on the spot market, and pay the pipeline's demand charge plus the interruptible rates, than to purchase the pipeline's gas. This is inefficient and disadvantages customers because they must pay extra for the inferior interruptible transportation service even though it is used in lieu of firm transportation rights embedded within their bundled, city-gate, firm sales services.

none reported contract demand conversions prior to 1988." *Id.* n. 7. The Commission lifted the stay on the effectiveness of 18 CFR 284.10, which permits contract demand conversions, effective November 1, 1987. Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, 52 FR 35539 (Sept. 22, 1987). FERC Stats. & Regs. (Regulations Preambles 1986–1990) ¶ 30,764 (1987).

TABLE 4.—MONTHLY NATURAL GAS PRICES WACOG, WELLHEAD PRICES AND DELIVERED TO PIPELINE PRICES

[a] [b]	$/MCf [c] WACOG NGM EIA	$/MCf [d] wellhead NGM EIA	$/MCf [e] Composite spot wellhead NGW	$/MCf [f] Composite spot dlvd pipeline NGW	$/MCf [g] Composite national spot dlvd pipeline NGI	[c]-[d] [h] WACOG minus wellhead EIA	[c]-[e] [i] WACOG minus spot wellhead NGW	[c]-[f] [j] WACOG minus dlvd pipeline NGW	[c]-[g] [k] WACOG minus dlvd pipeline NGI
1987:									
January	2.29	1.74	1.43	1.49		0.55	0.86	0.80	
February	2.29	1.73	1.45	1.53		0.56	0.84	0.76	
March	2.06	1.73	1.44	1.53		0.33	0.62	0.53	
April	2.05	1.69	1.40	1.51		0.36	0.65	0.54	
May	2.15	1.65	1.40	1.45		0.50	0.75	0.70	
June	2.04	1.65	1.38	1.43		0.39	0.66	0.61	
July	2.19	1.66	1.36	1.38		0.53	0.83	0.81	
August	1.64	1.63	1.34	1.34		0.01	0.30	0.30	
September	2.17	1.56	1.33	1.36		0.61	0.84	0.81	
October	1.96	1.57	1.34	1.37		0.39	0.62	0.59	
November	2.06	1.64	1.47	1.54		0.42	0.59	0.52	
December	2.17	1.70	1.69	1.82		0.47	0.48	0.35	
1988:									
January	2.04	1.97	1.78	1.92		0.07	0.26	0.12	
February	2.22	1.88	1.73	1.86		0.34	0.49	0.36	
March	2.03	1.76	1.54	1.57		0.27	0.49	0.46	
April	2.12	1.64	1.38	1.44		0.48	0.74	0.68	
May	2.17	1.57	1.32	1.37		0.60	0.85	0.80	
June	2.05	1.58	1.30	1.39		0.47	0.75	0.66	
July	1.94	1.59	1.33	1.45		0.35	0.61	0.49	
August	2.09	1.59	1.45	1.58		0.50	0.64	0.51	
September	2.13	1.61	1.59	1.72		0.52	0.54	0.41	
October	2.31	1.62	1.60	1.73		0.69	0.71	0.58	
November	2.19	1.72	1.71	1.88		0.47	0.48	0.31	
December	2.25	1.86	1.83	2.05		0.39	0.42	0.20	
1989:									
January	2.35	1.99	1.77	1.99		0.36	0.58	0.36	
February	2.16	1.81	1.50	1.72		0.35	0.66	0.44	
March	2.14	1.69	1.36	1.56		0.45	0.78	0.58	
April	2.19	1.56	1.38	1.59		0.63	0.81	0.60	
May	2.11	1.61	1.49	1.66		0.50	0.62	0.45	
June	2.05	1.65	1.50	1.66		0.40	0.55	0.39	
July	2.00	1.65	1.46	1.64	1.52	0.35	0.54	0.36	0.48
August	2.11	1.61	1.43	1.60	1.48	0.50	0.68	0.51	0.63
September	2.08	1.55	1.39	1.55	1.42	0.53	0.69	0.53	0.66
October	2.13	1.58	1.41	1.62	1.44	0.55	0.72	0.51	0.69
November	2.23	1.66	1.64	1.83	1.63	0.57	0.59	0.40	0.60
December	2.39	1.92	2.00	2.19	1.95	0.47	0.39	0.20	0.44
1990:									
January	2.42	2.22	2.16	2.34	2.29	0.20	0.26	0.08	0.13
February	2.17	1.85	1.63	1.77	1.83	0.32	0.54	0.40	0.34
March	1.94	1.56	1.38	1.51	1.38	0.38	0.56	0.43	0.56
April	2.17	1.50	1.35	1.55	1.40	0.67	0.82	0.62	0.77
May	1.98	1.47	1.35	1.54	1.38	0.51	0.63	0.44	0.60
June	2.18	1.49	1.36	1.55	1.38	0.69	0.82	0.63	0.80
July	2.00	1.50	1.32	1.49	1.33	0.50	0.68	0.51	0.67
August	1.86	1.51	1.28	1.45	1.27	0.35	0.58	0.41	0.59
September	1.93	1.57	1.33	1.47	1.29	0.36	0.60	0.46	0.64
October	2.18	1.79	1.51	1.69	1.48	0.39	0.67	0.49	0.70
November	2.45	1.99	1.87	2.05	1.88	0.46	0.58	0.40	0.57
December	2.58	2.07	1.84	1.97	2.03	0.51	0.74	0.61	0.55
1991:									
January	2.23	1.95	1.52	1.61	1.71	0.28	0.71	0.62	0.52
February	1.98	1.57	1.26	1.37	1.28	0.41	0.72	0.61	0.70
March	2.06	1.46	1.22	1.29	1.23	0.60	0.84	0.77	0.83
April	1.91	1.47	1.19	1.27	1.24	0.44	0.72	0.64	0.67
May	2.04	1.42	1.16	1.23	1.22	0.62	0.88	0.81	0.82
June	1.98	1.39	1.08	1.15	1.19	0.59	0.90	0.83	0.79
July	1.87	1.31	1.04	1.12	1.06	0.56	0.83	0.75	0.81
August	1.77	1.37	1.15	1.23	1.11	0.40	0.62	0.54	0.66
September	1.81	1.50	1.39	1.47	1.31	0.31	0.42	0.34	0.50
October	1.96	1.73	1.54	1.63	1.57	0.23	0.42	0.33	0.39
November	2.01		1.66	1.76	1.66		0.35	0.25	0.35
December			1.65	1.73	1.82				

Sources:

Column [c] WACOG, Energy Information Administration, "Natural Gas Monthly", Table 4. Column 3, "Purchased from Producers", prices reported in $/Mcf, February 1989, February 1991, February 1992.

Column [d] Wellhead Price, Energy Information Administration, "Natural Gas Monthly", Table 4. Column 1, "Wellhead Price", prices reported in $/Mcf, February 1989, February 1991, February 1992.

Column [e] Composite Spot Wellhead Price, "Natural Gas Week", January 6, 1992 Prices are published in $/MMBtu, converted to $/Mcf conversion factor $MMbtu*(1mcf/1.031Btu).

Column [f] Composite Spot Delivered to Pipeline Price, "Natural Gas Week", January 6, 1992 Prices are published in $/MMBtu, converted to $/Mcf conversion factor $MMbtu*(1mcf/1.031Btu).

Column [g] Composite National Weighted Spot Gas Average (delivered to pipelines), Interstate Average, "Natural Gas Intelligence Gas Price Index", Various Issues Prices are published in $/MMBtu, converted to $/Mcf conversion factor $MMbtu*(1mcf/1.031Btu).

The main reason that pipeline sales customers have not converted to firm transportation to satisfy their needs is that the transportation embedded within the pipelines's bundled city-gate, firm sales service is superior in quality to the pipeline's separately available firm transportation service. This is because, as the commenters opposing mandatory unbundling amply prove, the transportation embedded within the pipeline's bundled, city-gate, firm sales service is more reliable and flexible to meet their peak needs more than the firm transportation service that is available to be combined with sales by nonpipeline merchants.[63] For example, firm transportation is less flexible than pipeline sales service because most firm transportation is subject to daily scheduling and balancing requirements that do not apply to sales service. In addition, a firm transportation shipper may be penalized if its daily swings vary by more than 10 percent from the amount the shipper scheduled for transportation, whereas sales customers do not pay penalties for variances from their projected purchases.

Under current circumstances pipeline sales service is more reliable because the pipelines' ability to make timely deliveries on demand is greater than their competitors' ability to do so. Simple put, the pipelines' bundled, firm sales service has available to it component services not available to firm transportation. For example, many pipelines have access to substantial storage capacity to aid their own sales, but many pipelines do not provide open access, contract storage services for others.[64] This limits the firm shippers' ability to aggregate supplies for future use in a manner similar to the pipeline's aggregating ability.[65] In addition, pipelines entered into contracts with other pipelines for upstream capacity rights when the pipelines were providing very limited transportation services. Pipelines with those capacity rights on upstream pipelines are able to reach more producers than gas purchasers without that capacity.[66] Thus, the firm transportation service embedded within the pipelines' bundled, city-gate, firm sales service is superior to the pipelines' open access firm transportation service. This means that pipelines and other gas suppliers are not competing on an even basis for sales customers, even where firm transportation is available to move the gas sold by the pipelines' competitors.

The Commission believes that this lack of comparability between pipeline open access firm transportation service and pipeline bundled, city-gate, firm sales service is a major reason why pipeline customers have not converted to firm transportation service to a greater degree.[67] Indeed, the commenters opposing mandatory unbundling specifically cited the difference in quality between pipeline firm sales and firm transportation as the reason why customers had not converted to firm transportation.[68]

This means that considerable firm capacity rights are restricted to pipeline sales gas and may not be used to move gas sold by others on a firm basis. Thus, gas sold by others must often move through interruptible transportation—which reduces its quality and value especially during peak demand periods.

The result is that nonpipeline gas sellers are also disadvantaged because they cannot compete for long-term supply arrangements since their access to superior firm transportation is artificially limited and their gas is therefore transported on an interruptible rather than a firm basis. This movement of gas sold by others via mainly interruptible transportation results in facially uneven competition between pipeline merchants and other gas suppliers because firm sales service is of a higher quality than interruptible transportation service by definition. Of necessity, this inhibits nonpipeline gas suppliers in their quest to secure long-term supply arrangements with LDCs and end users, such as industrials and gas-fired electric generators because, unlike the pipeline, those merchants cannot assure delivery at the city-gate in all circumstances. Simply put, the pipeline can interrupt its competitor's transportation service on reasonable notice when the pipeline needs the capacity for its own bundled, city-gate, firm sales service. Moreover, gas purchasers are inhibited from securing long-term supply arrangements with nonpipeline gas suppliers because the gas must often move through interruptible transportation, or at best inferior firm transportation.

While gas purchasers and nonpipeline sellers are clearly disadvantaged under current circumstances, pipelines are not the beneficiaries. Pipelines also are disadvantaged by the current environment. Pipelines have certificate and contractual obligations that require them to stand ready to provide gas on demand without notice. However, the pipeline's sales customers are under no obligation to buy gas from the pipeline. Compounding the pipelines' difficulty is that under existing regulations they cannot have the kind of pricing flexibility they need to price their gas to compete with unregulated sellers. As a result, pipelines have suffered a significantly declining share of the sales market since the adoption of Order No. 436.[69]

The Commission believes that the primary reason for this is the way that pipelines sell their gas. Pipelines are allowed to earn only a regulated return on their transportation business. Because pipelines sell gas bundled with a transportation service over which they possess market power, the Commission requires pipelines to sell their gas at cost to ensure that pipelines cannot shift the recovery of monopoly profits from their transportation service to the sale of the, now deregulated, commodity. The cost-based rate at which the Commission has required the pipelines to sell their gas is their weighted average cost of gas (WACOG). The Commission does not permit a pipeline to sell gas at a market rate unless the pipeline demonstrates that its sales markets are sufficiently competitive to prevent it from exercising significant market power. To make its case, the pipeline must show that its firm transportation service is comparable in quality to the firm transportation embedded within its firm sales

[63] A comparison of the share of pipeline sales to total deliveries for market by quarters also attests to the superiority of pipeline bundled sales services. As shown in Table 1, pipeline sales in the first (January, February, and March) and fourth quarters (October, November, and December) are greater than their shares for the rest of the year.

[64] Contract storage means that a pipeline customer has a contract with the pipeline which enables the customer to inject its own gas into and withdraw that gas from the pipeline's storage facilities.

[65] See *infra* on storage.

[66] See *infra* on upstream pipeline capacity rights.

[67] Many commenters asset that until the issuance of Order No. 500–J, on February 13, 1991, uncertainty about the Commission's pregranted abandonment rule hindered conversions. See n.16, *supra*.

[68] Reply Comments of United Distribution Companies (UDC) at 7 ("The remaining pipeline sales service is largely used to provide swing service during the winter months and therefore cannot be converted absent comparable transportation.").

[69] See table 1.

service [70] and that adequate divertible gas supplies exist in its sales markets.[71] Most pipelines have not switched from cost-based, WACOG pricing to market-based pricing. Therefore, they are at a disadvantage when competing with the unregulated, market-based pricing of other merchants in the gas supply market. Because recently the WACOG has been above the spot gas price, pipeline customers often choose to buy their gas elsewhere and ship it under the pipelines' interruptible transportation services.[72]

In sum, under the current situation pipelines are disadvantaged in selling gas through WACOG pricing, customers are disadvantaged by using interruptible transportation in addition to paying the demand charges for firm sales, and nonpipeline sellers are disadvantaged because their gas must move mostly with interruptible transportation.

Based upon the record here and the Commission's observations of the gas industry since the advent of open-access transportation, the Commission believes that the main reason for this current situation, which disadvantages all segments of the natural gas industry, is the continued existence of the pipelines' bundled, city-gate, firm sales service. This service reserves a considerable amount of pipeline capacity throughout the year in order to ensure peak service. Hence, pipelines must sell at their WACOG throughout the year and gas purchasers must use a considerable amount of interruptible transportation to acquire competitively priced gas from other gas sellers. In addition, the pipelines' existing bundled, city-gate firm service gives pipelines an undue competitive advantage over other natural gas suppliers in making peak sales because nonpipeline merchants must deliver gas to their customers using inferior firm and interruptible transportation services.

The bundled, city-gate firm sales service gives pipelines an undue competitive advantage *vis a vis* other gas merchants that is not in the public interest as described by Congress in enacting the Decontrol Act. Pipeline transportation of its own gas on superior terms over the transportation (mainly interruptible) of other supplies will inhibit the "unimpeded transmission of market signals" and the "unimpeded operation of market forces" so that gas purchasers and sellers will be forced to make decisions in "distort[ed] natural gas markets" because of "erroneous market signals".[73] Over the long-run, this uneven transportation will, therefore, inhibit the production of an adequate supply of natural gas at reasonable prices and retard the nation's ability to reduce its dependence on foreign oil and to solve environmental problems by greater use of clean and abundant domestic natural gas.[74]

The pipelines' bundled, city-gate, firm sales service, therefore, has a harmful impact on competition between pipelines and other gas merchants, on the creation of a national wellhead market for gas where consumers will have access to an adequate supply of gas at reasonable prices, and on the nation's need to rely more on clean and abundant domestic natural gas. However, the Commission realizes that the pipelines' bundled, city-gate, firm sales service has the objective of providing a "no-notice" service where firm sales customers can receive gas up to their daily contract entitlements on demand without nominating that amount or incurring a penalty.[75] The delivery of supplies on a "no-notice" basis is in the public interest because it enables pipeline customers to meet unexpected changes in peak service needs caused, for example, by an unexpected change in temperature.

In evaluating a "rule, regulation, practice, or contract," [76] the Commission "must carefully balance the competitive harm the term causes against the term's objectives in light of the alternatives available for achieving those objectives." [77] In this instance, the "term" upon which the Commission has focused is the pipelines' bundled, city-gate, firm sales service and its impact on the current competitive environment. The Commission will strike down or alter a contract as an unreasonable restraint of trade "[o]nly if on balance the term causes more harm than is warranted in light of the term's objectives and the available alternatives[.]" [78]

Based upon the extensive record developed in this entire proceeding,[79] as well as the Commission's observations of the industry, the Commission finds that the pipelines' bundled, city-gate, firm sales service is operating, and will continue to operate, in a manner that causes considerable competitive harm to all segments of the natural gas industry as described above. The Commission finds that this harm has an unreasonable impact on gas sellers and gas purchasers and is an unlawful restraint of trade which is not balanced by the "no-notice" aspect of the bundled, city-gate sales service because, as fully discussed below, the pipelines can and will be able to provide a "no-notice" transportation service for all gas supplies without the competitive harm attendant to the current bundled, city-gate, firm sales service. Restricting access to a "no-notice" service by limiting its availability to the purchase of pipeline sales gas is anticompetitive. The bundled, city-gate, firm sales service provides the pipelines with an undue advantage and subjects other gas merchants to an undue disadvantage. It maintains an unreasonable difference in service between classes of service (bundled, city-gate, firm sales and open access firm transportation) because the firm transportation embedded within the firm sales is superior in quality as discussed above. The Commission, therefore, finds and concludes that the pipelines' bundled, city-gate, firm sales service violates NGA sections 4(b) and 5(a).

The Interstate Natural Gas Association of America (INGAA) disputes the Commission's conclusion that the pipelines' bundled, city-gate, firm sales service is anticompetitive. INGAA states that "pipeline bundled sales service is not an impediment to the

[70] *E.g.*, United Gas Pipe Line Co., 55 FERC ¶ 61,330 at p. 61,974 (1991) ("United must specifically demonstrate that its transportation services and storage services available to firm transportation customers are comparable to the transportation and storage in its bundled service offered at market-based rates.").

[71] The Commission has found that a pipeline's sales are made in a sufficiently competitive market when the pipeline provides comparable transportation service with respect to all gas supplies from whomever purchased and when adequate divertible gas supplies exist. *E.g.*, Transcontinental Gas Pipe Line Corp., 55 FERC ¶ 61,446 (1991), *order on reh'g*, 57 FERC ¶ 61,345 (1991); El Paso Natural Gas Co., 54 FERC ¶ 61,316 (1991), *order on reh'g*, 56 FERC ¶ 61,290 (1991).

[72] See table 4.

[73] S. Rep. No. 39, *supra*, at p. 2.

[74] *Id.* and H.R. Rep. No. 29, *supra*, at p. 2.

[75] The Commission understands that the pipeline and its customers are in close communication throughout the day. Nonetheless, the existing sales customer is not bound by any initial nominations or updated nominations.

[76] NGA Section 5(a), *supra*.

[77] Transwestern Pipeline Co., 36 FERC ¶ 61,175 at p. 61,439 (1986), *Aff'd. Transwestern Pipeline Co.* v. *FERC*, 820 F.2d 733 (5th Cir. 1987), *cert. denied*, 484 U.S. 1005 (1988) (The court affirmed the Commission's elimination of Transwestern's fixed cost minimum bill as not justified in view of its competitive harm.).

[78] *Id.* (The Commission found that "Transwestern's minimum bills caused more harm than was warranted . . . [and] concluded that the minimum bills unreasonably restrained trade and hence were unjust and unreasonable.").

[79] As discussed, *infra*, the Commission received comments in connection with a May 10, 1991 public conference, the Notice of Proposed Rulemaking, issued July 31, 1991, and a technical conference held on January 22, 1992.

sellers of firm sales service and therefore is not anticompetitive." [80] INGAA refers to its 1990 numbers which show that "firm transportation volumes for non-pipeline shippers accounted for 28 percent of total volumes delivered for market compared with pipeline sales of 21 percent." [81] INGAA states that this demonstrates that "pipelines are no longer the dominant providers of the merchant service." [82]

As discussed above, the Commission believes that this decline in pipeline sales is due to their selling gas under cost-based, WACOG pricing of the bundled, city-gate, firm sales service. Moreover, INGAA fails to note the fact that firm sales customers have not reduced their sales CD entitlements by nearly as much as they have reduced their purchases.

The Commission draws a different conclusion from INGAA's numbers with respect to long-term gas supply arrangements and sales to meet the peak needs of gas purchasers. The Commission concludes that in those situations the pipelines have a competitive advantage because the firm transportation embedded within their bundled, city-gate, firm sales service is superior in quality to both the firm transportation and the considerable amount of interruptible transportation used to move gas sold by nonpipeline merchants to LDCs and end user, such as industrials and gas-fired electric generators.[83] In particular, the Commission finds that the pipelines have an undue advantage over their merchant competitors in securing long-term gas supply arrangements with customers because, as discussed above, the pipelines currently have a superior ability to deliver gas on demand to meet the peak needs of LDCs and other customers. For example, the pipelines have access to storage to meet the customers' needs on demand.[84] In general, nonpipeline merchants have not been able to obtain access to storage for the gas that they sell because the Commission has not required the pipelines to offer open access contract storage.[85] The pipelines' competitive advantage *vis a vis* the needs of gas purchasers at peak is shown by the significantly increased share of pipeline sales to total deliveries for market in peak quarters over nonpeak quarters, and by the significantly higher prices they receive for gas (see table 4). In 1989–1990, the percentage of pipeline sales in peak quarters was double its share in offpeak quarters,[86] and in 1990-91 two-thirds of pipeline sales were in the winter months (see table 3). Thus, the Commission draws a different conclusion from INGAA's numbers.

The Commission finds that the pipelines' bundled, city-gate, firm sales service gives pipelines an undue advantage over other gas sellers because of the superior quality of the "no-notice" aspect of the transportation embedded within the bundled, city-gate, firm sales service when compared to the firm and interruptible transportation available for the gas of nonpipeline gas sellers. The Commission understands the counter argument made by the pipelines. That is, unless they are relieved of their service obligation to their firm sales customers, they must maintain the ability to serve those customers at peak. As noted above, their firm sales customers do not buy most of their gas from the pipelines, but the pipelines must be ready to serve them by selling gas to them during periods of peak demand. This situation is the nub of the service obligation problem that the Commission is addressing in this order. In order to secure a more efficient marketplace, the Commission must address the lack of equality in transportation (and storage) services, the pipelines' dominance in the peak period sales, the lack of flexibility in pipelines' sales pricing, and the pipelines' remaining service obligation simultaneously.

The Commission recognizes that over the past several years, the pipeline industry has been moving toward improving the quality of firm transportation and storage services available to competing sellers. However, the amount of capacity reserved for pipeline firm sales still far exceeds the pipelines' actual sales so that capacity is not available for firm transportation and, as a result, interruptible transportation maintains a significant share of peak period transportation. Thus, competing sellers continue to be at a disadvantage. In addition, firm transportation service is still subject to many more restrictions than necessary as compared to pipeline bundled firm sales service. Therefore, although the trend in the industry has been moving toward more even competition, the Commission finds it necessary to act here to accelerate and complete the transition toward a more efficient market.

In sum, the Commission believes that all segments of the natural gas industry are unduly disadvantaged by the current regulatory structure of the industry. The Commission must, therefore, act under NGA section 5 to determine the just and reasonable "rule, regulation, practice [and] contract[s]" to be "observed and in force".[87]

VI. The Remedy

A. The Remedy Proposed in the NOPR

Having found the current regulatory structure leads to unjust and unreasonable results, the question remains what the appropriate remedy is to address this situation. On July 31, 1991, the Commission proposed changes to its regulation of interstate natural gas pipelines to remedy the pipelines' undue competitive advantage.[88] The July 31 Notice of Proposed Rulemaking (NOPR) was, among other things, the outcome of a public conference held on May 10, 1991, where members of the natural gas industry discussed with the Commission the role of interstate natural gas pipelines in today's natural gas markets.[89]

In brief, the NOPR proposed to amend Part 284 of the Commission's regulations [90] as follows:

- Pipelines would be required to unbundle (*i.e.*, separate) their sales and transportation services with one exception for continued bundled sales to small customers. Pipelines would, however, be allowed to repackage their unbundled services to replicate their bundled, city-gate, sales services.
- The definition of transportation would be amended to include storage so that storage would be provided on an open access contract basis.
- Pipelines would be required to provide an open access transportation service that is comparable in quality for all gas supplies,

[80] Initial Comments at 8.

[81] *Id.*, at 9.

[82] *Id.*, quoting INGAA July 1991 paper, *supra*, at p. 1.

[83] Interruptible transportation amounted to 51 percent of total deliveries for market in 1990. INGAA November 1991 paper, *supra*, Table A-6.

[84] Withdrawals from storage are significantly greater during peak months than during offpeak months. Energy Information Administration/ Monthly Energy Review (Feb., 1992); DOE/EIA-0135 (92/02). From: Table 4.2, Natural Gas Supply and Disposition; Energy Information Administration/ Natural Gas Monthly (Feb., 1992); DOE/EIA-0130 (92/02). From: Table 18, Underground Natural Gas Storage—Interstate Operators of Storage Fields, 1985–1991.

[85] See *infra* on storage.

[86] See n. 63, *supra* for a comparison of pipeline sales for peak and offpeak quarters.

[87] NGA section 5(a), *supra*.

[88] Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation Under part 284 of the Commission's Regulations, 56 FR 38372 (Aug. 13, 1991), IV FERC Stats. & Regs. ¶ 32,480 (1991).

[89] All future references to pipelines are to interstate pipelines. Except for expanding the part 284 definition of transportation to include storage, the regulations adopted by this order do not apply to intrastate pipelines.

[90] 18 CFR part 284.

whether purchased from the pipeline or elsewhere.

• Firm transportation customers of downstream pipelines would be assigned capacity on upstream pipelines now held by downstream pipelines.

• Pipelines would be required to implement a capacity releasing propram.[91]

• Pipelines would be granted blanket certificates for unbundled sales services and would be subject to standards of conduct in connection with unbundled sales services similar to those applicable to affiliate sales.[92] The unbundled sales services would be subject to pregranted abandonment.

• Pipeline transportation rates would be designed under the Straight Fixed Variable method unless the parties to a proceeding otherwise agree (however, measures would be permitted to mitigate cost shifts, if necessary).[93]

• Pipelines would be required to initiate restructuring discussions with all interested parties within 30 days of the effective date of the Final Rule and to file a restructuring plan on or before the required date set forth in the regulations. Prior to the effective date of a restructuring filing, the holders of firm capacity would be required to exercise a right of first refusal by giving notice that they want to continue their contractual arrangement and that they agree to match and pay any greater rate up to the maximum rate and to match the most favorable contract term offered by others seeking firm capacity.

B. Comments on the NOPR

The NOPR proposed to require pipelines to unbundle (*i.e.*, separate) their sales and transportation services with one exception for continued bundled sales to small customers. A substantial number of commenters from all segments of the natural gas industry support the NOPR's mandatory unbundling proposal.[94] However, a substantial number of pipeline and LDC commenters oppose mandatory unbundling.[95] In brief, they state that, on some pipelines, a bundled, city-gate, firm sales service is necessary so that pipeline customers can receive service on demand to meet unexpected changes in peak service needs caused, for example, by an unexpected change in temperature. This is known as "no-notice" service.[96]

In addition, it is stated that pipelines will not be able to provide instantaneous transportation service if they must unbundle their sales and transportation services.[97] Instantaneous service occurs when the pipeline delivers gas to its downstream customer when the gas is injected into the pipeline upstream. This differs from "no-notice" service where a pipeline customer can take delivery without regard to injections into the pipeline system at the same time.

On January 22, 1992, representatives from all segments of the natural gas industry discussed with the Commission at a technical conference issues with respect to the operational aspects of the NOPR. In connection with that conference, interested persons filed written responses to questions posed by the staff in the appendix to the notice of the technical conference.[98] The information obtained at the technical conference, as well as from the initial and reply comments to the NOPR,[99] has been very helpful to the Commission in fashioning the final rule. The Commission has evaluated all the comments received but specifically addresses below only those that opposed the action adopted in this final rule. Comments that addressed proposals in the NOPR that are not adopted in this final rule are not specifically addressed, nor are comments that raised issues not relevant to the decisions reached here.

C. Remedial Action in the Final Rule

The question is what remedial action is appropriate to counter the pipelines' undue advantage as merchants providing bundled, city-gate sales service while retaining the reliable, "no-notice" service for pipeline customers that want such a service. As stated above, the NOPR proposed to eliminate the bundled, city-gate, sales service with an exception for small customers, and recognized that pipelines could package their various services to achieve the equivalent of a bundled, firm sales service.

Significantly, the representatives of the pipeline industry participating in the technical conference indicated a significant shift in their position from that stated in the written comments. Initially, the pipelines took the position that the bundled, city-gate, firm sales service is essential to the providing of "no-notice" and instantaneous service. However, at the technical conference they acknowledged that pipelines can provide those services for the delivery of any shipper's gas if permitted to retain adequate operational control of the use of their facilities.[100] Indeed, the information received at and after the technical conference reveals that a significant majority of the public—cutting across all segments of the industry—share and support this proposition.

The comments received at the technical conference highlighted several important matters. First, unbundling should have no perceptible effect on the reliability of a pipeline's peak day delivery services for heat sensitive residential loads. Second, the Commission, most pipelines, producers, most LDCs, marketers, and industrials agree that the pipeline should maintain operational control of the pipeline facilities, but importantly, in a manner that does not constitute any compromise of nondiscriminatory, fully equal, transportation services. Third, there are a number of operating and contractual tools to ensure that the pipeline, its customers and its shippers will take the necessary actions to maintain the reliable operation of the system—and those tools are not theoretical or speculative. They are in use today on the El Paso, Northwest and Transco systems and they have been proposed for the Northern Natural system. The details would be among the issues that would be worked out in the restructuring proceedings. Fourth, the

[91] The NOPR proposed that capacity brookering certificates by individually terminated.

[92] Inquiry Into Alleged Anticompetitive Practices Related to Marketing Affiliates of Interstate Pipelines, Order No. 497, 53 FR 22139 (June 14, 1988), FERC Stats. & Regs. [Regulations Preambles 1986–1990] ¶ 30,820 (1988), order on reh'g, Order No. 497–A, 54 FR 52781 (Dec. 22, 1989), FERC Stats. & Regs. [Regulations Preambles 1986–1990] ¶30,868 (1989), order extending sunset date, Order No. 497–B, 55 FR 53291 (Dec. 28, 1990), FERC Stats. & Regs. [Regulations Preambles 1986–1990] ¶ 30,908 (1990), order extending sunset date and amending final rule, Order No. 497–C, 57 FR 9 (Jan. 2, 1992), III FERC Stats. & Regs. 30,934 (1991), *reh'g denied*, 57 FR 5815 (Feb. 18, 1992), 58 FERC ¶61,139 (1992).

[93] Straight Fixed Variable is defined *infra*.

[94] *E.g.*, Natural Gas Supply Association and Indicated Producers (NGSA), Independent Petroleum Association of America (IPAA), Transcontinental Gas Pipe Line Corporation, Consolidated Edison Company of New York, Inc., and the Public Service Commission of the State of New York.

[95] *E.g.*, Interstate Natural Gas Association of America, Coastal Companies, Distributors Advocating Regulatory Reform (DARR), and Cincinnati Gas and Electric Company.

[96] The firm sales customer may purchase gas up to its firm daily contract entitlement without incurring a penalty and even though the customer and the pipeline are in close communication, the customer is not bound by any initial nominations or updated nominations.

[97] Initial Comments of Texas Eastern Transmission Corporation, Panhandle Eastern Pipe Line Company, Trunkline Gas Company, and Algonquin Gas Transmission Company (PEC Pipeline Group) at 16–17.

[98] Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation Under part 284 of the Commission's Regulations, 57 FR 385 (Jan. 6, 1992).

[99] The Commission has accepted and considered all comments filed, including late-filled comments.

[100] *E.g.*, compare INGAA Initial Comments at 3, 4 and Technical Conference Tr. 36–38.

comments strongly evidence that current pipeline services, in fact, can be unbundled into separate transportation, storage, and balancing services with complete equality of treatment for all gas supplies, price transparency and without cross-subsidization so that customers are offered a menu of unbundled services. And, fifth, there is general agreement that *one* form of bundled transportation service that can be offered would be the no-notice peak service on which some LDCs continue to claim reliance, with either pipeline or nonpipeline supplied gas.

The Commission has shaped this rule, in part, in response to those comments by creating a new "no-notice" firm transportation service under which gas customers will be able to receive gas up to their daily contract entitlement without incurring a penalty (see *infra* for a discussion of "no-notice" transportation service). In light of the views expressed at the technical conference, the Commission is confident that the pipelines can unbundle their services and, by retaining operational control of their systems, transport gas, whether purchased from a pipeline or nonpipeline supplier, on a basis that is just as adequate and reliable as the current bundled, city-gate, firm sales service in meeting the needs of their customers and of gas consumers.

Therefore, the final rule adopts the remedial approach of the NOPR. The Commission finds that it is appropriate to require pipelines to unbundle their sales services from their transportation services at an upstream point near the production area. To accomplish this required unbundling, the Commission is using its authority under NGA section 5 to convert each pipeline's bundled, city-gate, firm sales service into an unbundled firm transportation service. The existing bundled city-gate service obligation is being supplanted through the procedures established by this rule. In its place, pipelines and their existing sales customers will be able to negotiate a new unbundled firm sales service to be performed under a new blanket sales certificate for all pipelines offering open access transportation under Subpart B or G of Part 284 of the Commission regulations, as discussed in greater detail below. After negotiation of a new sales agreement, the pipeline's obligation to sell gas to that customer will be co-extensive with that new agreement. As an additional remedy, the Commission is affording firm sales customers the opportunity during the restructuring proceedings established by this rule (see *infra*) to reduce their unbundled firm sales entitlements in whole or in part. This will enable those customers to freely negotiate to purchase gas from the pipeline under its new market-based sales service or to purchase gas from other gas suppliers. The end result will be that all gas will move from the production area to the city gate under firm or interruptible transportation service.

The NOPR referred to the possibility of unbundling at the wellhead, at production area receipt points into mainline facilities, at receipt points, at the intersection of separate mainline systems, or at several of those places. In addition, the NOPR recognized the use of pooling areas as a means to facilitate the aggregation of supplies by all merchants. Most commenters support the Commission's proposal to determine places of unbundling on a case-specific basis and not to mandate pooling areas. A few commenters suggest specific places for unbundling [101] while other commenters urge the Commission to mandate pooling areas.[102]

The Commission concludes that the precise places of unbundling should be determined in the restructuring proceedings established by this order. The Commission believes it would be unwise to mandate specific unbundling places for the pipeline industry in light of the different configurations of the pipelines and their sources of supply. However, the place of unbundling should be located as far upstream as possible. Similarly, as discussed below, the Commission encourages but will not mandate the establishment of market centers and pooling areas.

The Commission discussed above the pipelines' "no-notice" service where bundled, firm sales customers can receive gas up to their daily contract entitlement on demand without nominating that amount or incurring a penalty. The Commission finds that it is in the public interest for pipelines to provide a firm transportation service that is a "no-notice" service similar to that received under the bundled, city-gate, firm sales service. Therefore, the Commission is requiring all pipelines that make sales for resale on the effective date of this rule to offer in their tariffs a "no-notice" firm transportation service. This service must be available as of the effective date of the tariff sheets to be filed to comply with this rule. This service, discussed in more detail *infra*, must be available to all firm shippers. The mechanics of how this "no-notice" firm transportation service will be provided on a particular pipeline must be considered and developed in the restructuring proceedings established by this rule (see *infra*).

This new "no-notice" transportation service will be provided in addition to, rather than in lieu of, the pipelines' current open-access, firm transportation service where shippers must receive instantaneous but not "no-notice" service. The former "traditional" firm transportation service will still be subject to reasonable nominating, scheduling and other operational conditions, such as imbalance tolerances and penalties. However, the quality of this service should be enhanced under the steps taken here. These operational conditions, of course, must be devised and implemented on a nondiscriminatory basis. In assessing the pipeline's compliance filing, the Commission will seek to ensure that the pipeline is not attempting, through the "no-notice" transportation service, to simply replace one form of bundled service with another anti-competitive service.

In addition, the pipeline, or another gas merchant, could offer a "packaged" sales and transportation service where the separately sold sales and transportation services are packaged by a contract pursuant to which the gas purchaser allows the pipeline, or another gas merchant, to act as the gas purchaser's agent in making all arrangements necessary to deliver the gas to the city-gate.[103] However, the rates for each transportation service must be separately stated in the pipeline's tariff.

Since sales and transportation services must be offered on an unbundled basis, there would be no rate on file with the pipeline's tariff for an "agency" service. The "packaging" of separate services, offered under separate rate schedules, would be effected only by contracts between the gas purchaser and its agent. Whether or not the pipeline as a gas seller can collect a fee for acting as the gas purchaser's agent in arranging for pipeline services is a matter for negotiation between the pipeline and gas purchaser on entering into their sales contract. This is because the pipeline will be acting as agent in its capacity as a gas seller rather than as a

[101] *E.g.*, Tejas Power Corporation states that unbundling should take place at the wellhead while the American Paper Institute states that unbundling should occur at mainline receipt points.

[102] *E.g.*, the Independent Petroleum Association of America, Natural Gas Clearinghouse, Brymore Energy, Inc., Vesta Energy Company, and the Natural Gas Supply Association/Indicated Producers.

[103] See, *e.g.*, Transcontinental Gas Pipe Line Corp., 55 FERC ¶ 61,446 (1991), *order on reh'g*, 57 FERC ¶ 61,345 (1991).

gas transporter. Any agency fee would have to be recovered as part of the price for selling gas and not as part of the transportation rate. Of course, the pipeline must act in a non-discriminatory manner in offering agency services.

The Commission is not adopting the NOPR's proposal to continue a bundled, city-gate, firm sales service for small sales customers, because those customers can be served reliably through a combination of unbundled sales and the "no-notice" transportation service required by this rule. The pipeline or another gas seller could also act as the agent of the small customers and make all of the arrangements necessary to deliver the gas to the small customers in the same manner as under the current bundled, city-gate, firm sales service. In addition, as discussed further below, the small customers can continue to receive firm transportation under a one-part volumetric rate computed at an imputed load factor similar to the manner in which their current sales rates are determined.[104] Alternatively, as indicated by Florida Cities at the January 22, 1992 technical conference, small customers can band together to purchase gas.[105]

The Commission sees several reasons for requiring the unbundling of pipeline services and the creation of a "no-notice" transportation service, as opposed to retaining the pipelines' bundled, city-gate, sales service.

First, firm shippers will be able to select the form of pipeline transportation service that best suits their needs, both as to the quality and the prices of the individual services chosen. As stated, firm shippers will be able to choose a transportation service that provides "no-notice" service. In the alternative, firm shippers may elect a service of a different quality. For example, firm shippers can elect to continue the traditional open-access firm transportation service, if they do not want "no-notice" service. Or, firm shippers could purchase some combination of services, such as traditional firm transportation service and open-access contract storage. This complete menu of services will enable gas purchasers, sellers, and pipelines to fashion arrangements according to the demand for the services in lieu of the present system which binds individual services with separate costs together into one package. The gas purchaser, or nonpipeline seller will be able to make informed choices about services and the market will decide the need for the various services.

Moreover, the unbundling of pipeline services will enable all gas sellers (producers/marketers/pipelines) to compete on an even basis by offering the same sales services in the same market. At present, most pipeline sales are at the city gate at the WACOG price while most producers or marketer sales are at the wellhead or in the field at the market price. The unbundling of services will create competition for gas purchasers among gas merchants on more even terms. The competition for gas purchasers will not be skewed in favor of pipelines by their ability to offer a superior bundled, city-gate, firm sales service or against pipelines because of WACOG pricing. In addition, the competition between pipelines and other gas sellers in the same market should greatly reduce the pipeline's natural incentive in a bundled service environment to manage its pipeline system to favor itself as a merchant to the disadvantage of shippers of gas sold by others.

The Commission also believes that this new form of "no-notice" transportation service will be superior to the existing "no-notice" bundled, city-gate, firm sales service. This is because gas purchasers will be able to obtain "no-notice" transportation service for gas supplies purchased from any gas seller, not just from pipelines, rather than relying on inferior firm or interruptible transportation as discussed above.[106] This should enable gas purchasers to enter into more reliable supply arrangements with nonpipeline suppliers for both base and peak needs. Hence, gas purchasers will have more choices and more flexibility. In addition, the pipelines will be able to compete for more gas purchasers under market-based pricing in lieu of their WACOG pricing.

Some commenters argue that the Commission's fostering of competition cannot be a justification in and of itself for the regulations adopted here. Rather, they contend that the Commission is required to foster competition only when consumer interests are advanced and protected.[107] The Citizens Gas & Coke Utility sees nothing wrong with unequal competition so long as the merchants' differing products are appropriately priced. It maintains that "[t]he Commission should *not* mandate a homogeneous group of sellers." [108]

The Commission is not acting to protect competitors. Rather, the Commission, as discussed in detail above, is acting to improve the competitive structure of the natural gas industry to facilitate the operation of a national wellhead market as envisioned by Congress in order to provide natural gas consumers with access to an adequate supply of clean and abundant natural gas at reasonable prices. Moreover, the Commission is improving this competitive structure without undermining the reliability of service for pipeline customers by requiring pipelines to perform a "no-notice" transportation service. In short, the Commission is both promoting competition and protecting all gas consumer interests, especially with respect to the reliability and the pricing of services.

In addition, the Commission is not mandating a homogeneous group of gas merchants. Rather, the Commission is creating a regulatory environment that will provide all gas merchants with an equal opportunity to compete for gas purchasers. To be sure, not all gas sellers are similar. Some are more efficient than others. Some have greater expertise and some have more resources upon which to draw. However, by separating the various pipeline services needed by gas consumers, the Commission can assure the fair pricing of all services. The gas purchasers will be better off because of the ability to make informed choices about their gas purchasing decisions. Moreover, the rule will not change inherent advantages held by any gas merchant, whether it be a producer, marketer, or pipeline, on account of size, experience, or motivation. The Commission envisions a future gas market where buyers and sellers can meet to fashion deals according to their needs, with no decline in, and indeed with enhancement of, the quality and reliability of service for gas consumers.

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[104] Existing small sales customer rates are often determined by assuming a quantity of purchases which may be higher than actual purchases. Small customers, therefore, pay less for their service than they would if their rates were designed based on actual purchase levels.

[105] Technical Conference Tr. 277,293. In Florida, several municipal utilities banded together with one utility buying on behalf of the others. The Florida Cities representative reported that those utilities have achieved "tremendous economies." *Id.* at 291.

[106] Even if the sales customer elects to continue to contract for its gas needs with the pipeline under a market-based rate that includes a component that compensates the pipeline for standing ready to provide a certain quantity of gas at all times, the customer will have the right to purchase spot gas elsewhere and use its unbundled firm transportation to ship it.

[107] *E.g.*, the Cincinnati Gas & Electric Company, Union Light, Heat and Power Company, and Lawrenceburg Gas Company, Initial Comments at 13, 14, *citing, Brown Shoe Co.* v. *U.S.*, 370 U.S. 294, 320 (1962) and *Environmental Action, Inc.* v. *FERC*, 939 F.2d 1057, 1061 (D.C. Cir. 1991).

[108] Initial Comments at 7.

To that end, the Commission is amending part 284 in several ways to upgrade pipeline services used to transport gas, whether sold by a pipeline or another merchant. This will provide all gas purchasers with improved access to all gas sellers whether or not the gas purchasers want a "no-notice" firm transportation service.

In brief, the Commission is making ten changes in part 284. First, the Commission is revising §§ 284.8(a)(1) and 284.9(a)(1) to require firm and interruptible transportation services to be provided unbundled from firm and interruptible sales. This requirement also will be included as a condition on the blanket sales for resale certificates issued by this rule and discussed *infra*. Second, the Commission is adding §§ 284.8(b)(2) and 284.9(b)(2), which require a pipeline that offers firm and interruptible transportation services under Part 284 to provide those services on a basis that is equal in quality for all gas supplies whether purchased from the pipeline or another seller. Third, and fourth, the Commission is adding §§ 284.8(b) (3), (4), and (5) and 284.9(b) (3), (4), and (5) to require a pipeline to provide all shippers equal and timely access to certain information through the use of electronic bulletin boards, and to preclude any tariff provisions that would inhibit the development of market centers. Fifth, the Commission is amending § 284.1 to define transportation as including storage. Sixth, the Commission is adding § 284.242 to authorize and require open access pipelines to provide firm shippers on downstream pipelines with non-discriminatory access to capacity held by the downstream pipelines on upstream pipelines. Seventh, the Commission is adding § 284.243 to authorize a new firm capacity reallocation program so that firm shippers can release unwanted capacity to those desiring capacity.

Eighth, as discussed above, the Commission is adding § 284.8(a)(4) to require pipelines that make bundled sales on the effective date of this rule to provide a non-discriminatory "no-notice" firm transportation service. The "no-notice" transportation service as well as the other matters pertinent to open access transportation, will be discussed in Part VII.

Ninth, in order to further promote even competition among gas merchants, the Commission is adopting the straight fixed variable method of cost classification for the purpose of billing firm transportation customers unless the Commission provides otherwise. Under that method, all of a pipeline's fixed transmission and storage costs are billed in the pipeline's reservation charge.

Tenth, the Commission is issuing in this rule a blanket sales certificate to all pipelines so that they can make unbundled firm and interruptible sales on a comparable basis with unregulated merchants (*see infra*). This appears as a new subpart J to part 284.

Last, the Commission is also reemphasizing, as discussed fully below, the policy stated in §§ 284.221 (g) and (h) of its regulations that pipelines allow shippers to have flexible receipt and delivery points.

The Commission believes that the above-described remedial approach will both improve the competitive structure of the natural gas industry, by putting pipelines, when acting as merchants, and other gas merchants on an even footing with respect to essential pipeline services and will maintain the ability of the pipeline system to provide reliable service when needed—regardless of the source of the gas. All of the above remedial acts are discussed in detail below. In tandem with these changes the Commission has concluded that pipelines should be able to recover 100 percent of their prudently incurred costs associated with implementation of this rule. This is also discussed in detail, *infra*.

Based upon the extensive record compiled in this proceeding, the Commission believes that the above-described unified and comprehensive remedy will benefit all segments of the natural gas industry. To the extent members of the industry are currently facing an uncertain financial situation, the Commission believes that this rule will remove that uncertainty and create a regulatory framework that can adapt to changing market dynamics over the long-run. Indeed, this rule will establish an efficient gas market in which all participants are able to fashion the contractual arrangements—both long and short term—best suited to their needs. In short, they will be able to respond to their financial and commercial situation through the contracting process in an efficient gas market.

VII. Essential Aspects of, and Terms and Conditions for, Open-Access Transportation

A. Introduction

The Commission adopted Order No. 436 to prevent pipelines from discriminating in their choice of transportation customers in order to favor the pipelines' own sales services.[109] The Commission codified this anti-discrimination purpose in §§ 284.8(b) and 284.9(b) by requiring pipelines to offer their firm and interruptible transportation services "without undue discrimination" in the quality of service provided.[110] At the same time, the Commission recognized that pipelines need to impose "reasonable operational conditions" on their services to effectively manage their systems and §§ 284.8(c) and 284.9(c) permit this, provided the conditions are included in the pipeline's tariff.[111] In evaluating those operational conditions, the Commission dealt with many complex matters in its effort to ensure that there was no discrimination between the transportation embedded within the pipelines' bundled, city-gate, firm sales services and their open access firm transportation services.

Unbundling the sales and transportation components of the pipeline's city-gate, firm sales service changes the regulatory focus, but does not change the policy direction in which the Commission has been going. Before this order, the primary focus was on whether a pipeline's firm transportation service was comparable in quality to the firm transportation embedded within the bundled, city-gate, firm sales service.[112] After this order, the focus no longer will be on comparing the quality of two different pipeline services. Rather, the focus will be on ensuring that pipeline transportation of all gas supplies is performed on an equal basis under reasonable transportation terms and conditions that enable buyers to use open access transportation to maximize the benefits of a competitive wellhead natural gas market. To ensure equality of transportation service between gas sold by pipelines or their affiliates and gas sold by other gas sellers, the Commission's focus, after unbundling, must be on the quality of transportation service itself.

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[109] Order No. 436, *supra* n.2 p. 31,495 ("Examples of discrimination that the Commission finds to be undue or preferential within the context of self-implementing authorizations are refusals to transport for existing sales or non-fuel switchable customers and preference for affiliates.").

[110] 18 CFR 284.8(b) and 284.9(b).

[111] 18 CFR 284.8(c) and 284.9(c).

[112] *E.g.*, Tejas *supra*, at 1004 ("Without having first assessed the comparability of Texas Eastern's unbundled transportation and storage services, therefore, the Commission could not rationally conclude that the LDCs could take advantage of any alternative sources of gas."); United Gas Pipe Line Co., 55 FERC ¶ 61,330 at p. 61,974 (1991) ("United must specifically demonstrate that its transportation services and storage services available to firm transportation customers are comparable to the transportation and storage in its bundled service offered at market-based rates.").

The Commission recognizes the need to analyze operational conditions in light of the pipeline's need to effectively manage its transportation system and its obligation to perform the new "no-notice" transportation service.[113] But the Commission must ensure that the operational terms and conditions devised to ensure effective system management do not give a competitive advantage to unbundled pipeline and pipeline affiliate sales. It is vital to ensure that gas purchasers have a viable, meaningful alternative to pipeline sales under a market-based pricing mechanism.

B. Transportation Equality and Other Principles

The Commission is amending part 284 to require an open-access pipeline that offers firm and interruptible transportation services to provide those transportation services on a basis that is equal in quality for all gas supplies, whether purchased from the pipeline or elsewhere. This requirement, embodied in new §§ 284.8(b)(2) and 284.9(b)(2), will ensure that a pipeline, through a tariff provision or otherwise, does not give its own sales or the sales of an affiliate a preference over sales by other gas sellers in matters relating to Part 284 transportation. This equality principle will ensure that a pipeline cannot impose unreasonable restrictions on a shipper's ability to be served by other gas sellers. Any such restrictions would render transportation of gas sold by the pipeline or an affiliate superior in quality to transportation of gas of other merchants. Such a quality preference would result in undue discrimination under NGA sections 4 and 5 and is prohibited by the equality principle. As discussed above, after unbundling the focus must shift to ensure that the pipeline transports all gas supplies on an equal basis, not simply that the pipeline provides transportation of comparable quality for gas sold by other sellers with which it competes.

While a few commenters request the Commission to set forth uniform terms and conditions of service in the Commission's regulations,[114] the Commission concludes that such industry-wide specificity is not desirable in light of the differing configurations of pipeline systems and the differing needs of pipeline customers. Although the Commission will not develop generic, industry-wide, terms and conditions, the Commission will require that the terms and conditions that are developed must be applied in a non-discriminatory manner, must not give the pipeline or its marketing affiliate a competitive advantage, must not be unduly restrictive, and must be fair to all parties.

However, the Commission concludes that it should codify two other general principles in the regulations. The first is that nothing in a pipeline's tariff can inhibit the development of market centers or hubs. This appears in new §§ 284.8(b)(5) and 284.9(b)(5). While the Commission will not mandate market centers or hubs, it will prohibit tariff provisions that prevent their development.

The second general principle, embodied in §§ 284.8(b) (3) and (4) and 284.9(b) (3) and (4), is that pipelines must provide timely and equal access to any and all information necessary for buyer and sellers to arrange gas sales and capacity reallocations.[115]

The precise nature of the information should be developed in the restructuring proceedings established by this order. At a minimum, the Commission will require the pipeline to timely inform all interested persons about the availability of capacity at receipt points, on the mainline, at delivery points, and in storage fields, and whether the capacity is available from the pipeline directly or through capacity releasing.

To effect this requirement, those sections require all pipelines to use electronic bulletin boards. Since electronic bulletin boards have become standard industry-wide practice, the Commission has designed a rule that builds upon their use and sees no new burden in this requirement. Electronic bulletin boards in particular will be required to comply with the new capacity releasing requirement, discussed *infra*.

Pipelines must not provide preferential access to any users of the electronic bulletin board. They must permit users to download files from the board, so their contents can be reviewed in detail without tying up access to the board. Pipelines must also keep daily back-up records of the information displayed on their bulletin boards for at least three years and permit users to review those records, which should be archived and reasonably accessible. Pipelines must also periodically purge transactions from current files when transactions have been completed, so that users do not have to sift through massive amounts of historical data to find current information. Information on the most recent entries should appear ahead of older information. In addition, electronic bulletin boards must be "user-friendly." The Commission urges pipelines to use software that allows extremely large files to be split into small parts for ease of use. Furthermore, the Commission urges pipelines to utilize software with on-line help, a search function that permits users to locate all information concerning a specific transaction, and menus that permit users to access separately each record in the transportation log, notices of available capacity, and standards of conduct information. The Commission may revisit these minimum general standards as needs warrant.

The Commission reiterates that, to ensure equality of service, pipelines must include all operating terms, conditions, and rules in their tariffs with the maximum amount of specificity possible. The Commission will focus more closely on compliance with this rule, codified in §§284.8(c) and 284.9(c), after unbundling because it is essential to an efficient open access transportation service that the pipelines impose only legitimate and reasonable operational conditions of which all shippers have had advance notice.

The Commission in § 284.14 is requiring pipelines to have tariff provisions governing, at least, the following transportation matters. First, the pipelines must set forth in their tariffs their methods for allocating aggregate receipt point capacity, individual receipt point capacity, mainline segment capacity, storage capacity, and delivery point capacity. Second, as discussed below, the pipelines must set forth in their tariffs provisions governing shipper flexibility in changing receipt and delivery points. Third, the pipelines must set forth in their tariffs their provisions concerning supply and capacity curtailments,[116] the scheduling of gas injections into the mainline and into storage, the scheduling of gas deliveries from storage and from the mainline, the setting and charging of penalties, balancing rights, and the instantaneous receipt and delivery of gas. Fourth, the pipelines must set forth in their tariffs their provisions under which they will provide the "no-notice" transportation service required by this rule. The Commission will further discuss the pipeline's "no-notice" transportation service below.

[113] Various operational conditions which a pipeline might develop to manage its system are discussed in VII.D below.

[114] Fuel Managers Association, Appalachian Energy Group, Independent Petroleum Association of America, and American Paper Institute.

[115] See *infra* on capacity reallocations.

[116] See *infra*.

C. Capacity Reallocation

After reviewing the comments and reply comments, the Commission concludes that it is in the public interest for pipeline shippers to have the ability to reallocate unwanted pipeline capacity on a variety of bases to others seeking firm capacity. The only question is the best way to accomplish this on an industry-wide basis. The Commission concludes that this requires the adjustment of previously authorized capacity brokering and other capacity assignment (upstream capacity assignment and releasing) programs for two reasons. First, while the Commission has required that capacity be brokered or allocated on a nondiscriminatory basis,[117] the Commission no longer believes that it can adequately monitor capacity brokering under existing certificates to ensure that all allocations are nondiscriminatory. Simply put, there are too many potential assignors of capacity and too many different programs for the Commission to oversee capacity brokering as it now exists. Second, the Commission believes that the two new generic allocation of capacity programs it is adopting make the necessary adjustments to eliminate the potential for firm capacity holders to unduly discriminate in their assignment of capacity, and facilitate the development of the secondary transportation market.

The Commission, therefore, will not approve new individually authorized capacity brokering and other capacity assignment programs and is contemporaneously amending, by a separate order, the terms and conditions of existing capacity brokering and other capacity assignment certificates to conform to the capacity allocation regulations adopted by this rule. This is necessary to ensure that after the effective date of this rule all capacity reallocations are undertaken on the same basis on all pipelines. This will prevent any pipeline or firm shipper from achieving an undue advantage, or incurring an undue disadvantage, compared to firm shippers on other pipelines, from the working of the particular pipeline's capacity brokering program. Hence, the Commission is taking this action, in the above-noted order, to modify the terms of existing capacity brokering and other capacity assignment programs under NGA Section 5, as well as under the Commission's reserved right in those orders to modify a program, to ensure, as here, that they continue to be required by the public convenience and necessity.[118]

The Commission's treatment of "buy/sell" arrangements being considered in El Paso Natural Gas Co., *et al.*, Docket No. CP88-433-002, *et al.*, is related to the capacity brokering issue. Under those arrangements, an LDC will purchase gas in the production area from an end user or a merchant designated by an end user. The LDC will ship the gas on its own firm capacity and sell the gas to the end user at the retail delivery point. The Commission will not address buy/sell issues here but will do so in the EL Paso docket. As explained in that order, under this rule, buy/sell arrangements should not be necessary because, under the capacity releasing requirement, firm capacity holders will be able to release unwanted firm capacity to persons seeking firm capacity. However, existing buy/sell deals can continue if the firm capacity holder does not give up its capacity in the restructuring proceeding as discussed below.[119] Similarly, buy/sell deals executed between the date of this order and the date the pipeline's capacity releasing mechanism goes into effect can continue if the firm capacity holder does not give up its capacity in the restructuring proceeding as discussed below. After a pipeline's capacity releasing mechanism goes into effect, no new buy/sell deals may be executed after that date and thereafter *all* allocations of interstate pipeline capacity must be done under the capacity releasing mechanism. When the pipeline's capacity releasing mechanism goes into effect, it must post on its electronic bulletin board for a reasonable period the price, terms and conditions, and names of the parties to all buy/sell deals existing on that date. All firm capacity holders who have executed buy/sell deals prior to that date must provide such information to the pipeline for posting on the electronic bulletin board. This posting is to make those arrangements public and not to allow other persons to make a better offer.

1. Upstream Pipeline Capacity

As discussed above, the Commission is requiring pipelines to unbundle the sales and transportation components of their bundled, city-gate, firm sales services to remedy the pipelines' undue advantage as merchants of gas over other merchants. As stated, one reason for the pipelines' advantage is that, as bundled merchants, they had access to more gas suppliers because of capacity held on upstream pipelines that connect with those gas suppliers.

The unbundling of sales and transportation will occur in many instances near the production area. However, in some instances, unbundling of a downstream pipeline's sales and transportation services will occur where it interconnects with an upstream pipeline which provides the downstream pipeline with access to the production areas. The downstream pipeline will be able to use its transportation capacity on the upstream pipeline to acquire gas to make sales at the interconnection point to its (the downstream pipeline's) sales customers. The downstream pipeline would have an undue competitive advantage over other gas merchants because of the downstream pipeline's access to the capacity on the upstream pipeline. This situation would inhibit the goal of a competitive national market because the downstream gas purchasers would not have access to the production areas and gas merchants reached through the capacity held on the upstream pipeline by the downstream pipeline.

New § 284.242, therefore, provides that an open access upstream pipeline must permit a downstream pipeline to assign its firm transportation capacity (whether part 284 or individually certificated) on the upstream pipeline on a non-discriminatory basis to the downsteam pipeline's firm shippers. This rule also applies to contract storage capacity that the downstream pipeline holds on the upstream pipeline. In addition, the downstream pipeline will be required to assign its upstream firm transportation capacity (whether part 284 or individually certificated) and its upstream firm contract storage capacity to its firm transportation customers to the extent necessary to provide capacity to those shippers that desire upstream capacity. All § 284.242 reassignments will be permanent. While this reassignment should occur initially in

[117] *E.g.*, Texas Eastern Transmission Corp., 48 FERC ¶ 61,248 at p. 61,869-70 (1989), *clarified*, 48 FERC ¶ 61,378 (1989), *order on reh'g*, 51 FERC ¶ 61,170 (1990), *order on reh'g*, 52 FERC ¶ 61,273 (1990).

[118] *E.g.*, Texas Eastern Transmission Corp., 48 FERC ¶ 61,248 at p. 61,876 (1989).

[119] In the NOPR, the Commission requested comment on "whether termination of capacity brokering will have a negative impact on independent power producers or qualifying facilities who may be receiving gas service for electric generating purposes through, so-called, 'buy/sell' arrangements." If so, the Commission asked whether it should "provide some form of grandfathering of existing transactions as part of the transitional phase contemplated under the Final Rule?" IV FERC Stats. & Regs. ¶ 32,480 at p. 32,545 (1991). The Commission believes that the steps taken in the final rule should avoid having a negative impact on IPPS or QFs using gas. To the extent this is not the case, interested persons should inform the Commission on rehearing of this rule.

the restructuring proceedings,[120] § 284.242 will continue in effect after the restructuring proceedings to permit further reassignments of available upstream capacity held by downstream pipelines [121] to customers of downstream pipelines.

The NOPR proposed "that a downstream pipeline's capacity on an upstream pipeline should be considered as if that capacity were a mainline segment of the downstream pipeline * * * [and that a] downstream shipper's rights to [such] capacity would be determined under the method used by the downstream pipeline to allocate capacity on mainline segments[.]" [122] The Commission concludes that the issue of how to allocate capacity on upstream pipelines to shippers on downstream pipelines should be determined in the restructuring proceedings.

Texas Gas asks the Commission to clarify that the required allocation of capacity will not apply to interruptible capacity or capacity on intrastate pipelines or exchange transactions. The Commission clarifies that the requirement to allocate capacity on upstream pipelines to shippers on downstream pipelines does not apply to interruptible capacity held by downstream pipelines on upstream pipelines, to firm capacity held by downstream pipelines on intrastate pipelines, or to upstream exchange transactions.

Last, downstream pipelines subject to subparts B or G of part 284 will not be allowed to give up upstream pipeline capacity in the restructuring proceedings except under new § 284.242. This exception is necessary to ensure that firm customers of downstream pipelines have the first opportunity to gain access to capacity, on upstream pipelines, held by the pipeline to which the customers are directly connected. If the customers of downstream pipelines do not want the capacity on upstream pipelines, the downstream pipeline can release its capacity on upstream pipelines through the capacity release provisions of new § 284.243, discussed in the next section. If the downstream pipeline is unable to shed unwanted upstream capacity through releasing, it can seek to recover costs associated with the "stranded" upstream capacity as a transition cost as discussed, *infra*.

2. Voluntary Reallocation of Firm Transportation Capacity

The upstream pipeline capacity assignment requirement will provide customers of downstream pipelines with capacity needed on upstream pipelines. This will afford those customers with additional flexibility in their choice of gas sellers. However, this type of assignment is only one aspect of an adequate capacity assignment program. The Commission believes that it is necessary to adopt a program that contains several important elements of capacity brokering so that shippers can reallocate unneeded firm capacity on a variety of bases. Capacity reallocation will promote efficient load management by the pipeline and its customers and, therefore, efficient use of pipeline capacity on a firm basis throughout the year. Because more buyers will be able to reach more sellers through firm transportation capacity, capacity reallocation comports with the goal of improving nondiscriminatory, open access transportation to maximize the benefits of the decontrol of natural gas at the wellhead and in the field.

Accordingly, the Commission is adding a new § 284.243 to require all open access pipelines to provide a capacity releasing mechanism through which shippers can voluntarily reallocate all or part of their firm transportation capacity rights to any person who wants to obtain that capacity by contracting with the pipeline. Shippers may reallocate their firm transportation capacity (whether part 284 capacity or individually certificated capacity) only under § 284.243.

This capacity releasing mechanism would allow firm capacity holders to permanently or temporarily release some or all of their capacity through the pipeline to be reassigned to persons desiring capacity. The capacity releasing mechanism would afford buyers and sellers of firm capacity with one place to shop to ensure that firm capacity is used as efficiently as possible.

Capacity releasing will operate as follows. The firm capacity holder will inform the pipeline that it wants to release capacity on a permanent or temporary basis, the specific quantity to be released, the period of time, and any other conditions of the release. For example, the releasing customer might state that it will release a specified amount of capacity only so long as the temperature remains above a specified degree. That is, the firm shipper may release firm capacity on an interruptible basis. In addition, the releasing customer can bring to the pipeline for posting a pre-arranged deal for releasing capacity. If no better offer is received,[123] the pipeline *must* contract with the replacement shipper found by the releasing customer. If a better offer is forthcoming, the pipeline must give the replacement shipper found by the releasing customer an opportunity to match the better offer. If the replacement shipper matches the better offer, the pipeline must contract with the replacement shipper found by the releasing customer. If the releasing customer's designated replacement shipper does not match the better offer, the pipeline must contract with the person who made the better offer.

The pipeline must immediately post the capacity releasing information on its electronic bulletin board for a reasonable period of time during which applicants for capacity can agree to the releasing customer's terms and conditions.[124] As discussed below, the pipeline may take other action to market any released capacity.

The pipeline will be required to resell that capacity under part 284 to the applicant meeting the releasing customer's specifications. The replacement shipper must, of course, satisfy all of the pipeline's tariff provisions governing shipper eligibility before it can contract with the pipeline for the capacity. Unless the pipeline otherwise agrees (such as where there is a permanent reallocation of annual capacity), the releasing customer will remain liable on its contract but will receive a credit against its bill for the capacity resold. The pipeline itself should be indifferent to the substitution because its total contract demand will remain unchanged.[125]

Once the replacement shipper enters into a contract with the pipeline, the replacement shipper becomes a shipper like any other shipper and is subject to the pipeline's operational provisions as stated in its tariff. In addition, the replacement shipper as a shipper can also release its capacity through the pipeline's capacity releasing program. The pipeline's tariff must have provisions that clearly delineate the

[120] Section 284.242 capacity reassignment must be effectuated in the restructuring proceedings before downstream pipelines release their capacity under new Section 284.243 discussed below.

[121] If the downstream pipeline releases the capacity under new § 284.243, the capacity would be assignable, however, any prior release would remain in force.

[122] IV FERC Stats. & Regs. ¶ 32,480 at p. 32,551 (1991).

[123] The Commission will not define what constitutes a better offer because of the wide variety of potential releasing scenarios. The parties must consider in the restructuring proceedings the issue of what constitutes a better offer.

[124] For example, the pipeline should alert shippers in advance of the conditions under which the releasing shipper may recall released capacity.

[125] See *infra* on interruptible transportation capacity.

rights and obligations of such secondary releasing shippers and those of the primary releasing shipper.

The NOPR would have allowed the pipeline to sell its own uncommitted capacity prior to reselling that of a releasing customer. The new rule requires the pipeline to post its available capacity and terms and conditions on its electronic bulletin board. Potential purchasers of capacity will then be able to choose from among the pipeline and the releasers the service that best suits their needs.

The Commission will permit the pipelines and their customers, and other interested participants, to determine the details of a pipeline's capacity releasing program in the individual restructuring proceedings. For example, the NOPR proposed a seven day open season for applicants to agree to the releasing customer's terms. However, the Commission is not mandating a particular time period for an open season to avoid inhibiting needed flexibility. The participants in the restructuring proceedings may determine what is a reasonable period and may, for example, decide that different periods are needed for different types of released capacity. In addition, the participants should determine the pipeline's compensation for the capacity releasing program. This recompense would, of course, consist of a reasonable administrative fee to cover the pipeline's out-of-pocket expenses in connection with establishing and operating the capacity releasing program.[126]

Moreover, as a further incentive to effectuate capacity releases, the Commission will permit the pipeline to be compensated when it actively markets released capacity.[127] The participants in the restructuring proceedings must determine the appropriate amount of the pipeline's recompense (*e.g.*, a sharing of proceeds) when it takes affirmative action to market the released capacity, beyond posting the information on the bulletin board, and finds a replacement shipper. The releasing shipper will receive a net credit against its reservation fee for the proceeds of the resale minus the pipeline's recompense. The participants should determine what actions merit compensation. Even though the pipelines are required to post the releasing shipper's offer to release capacity, this recompense will give the pipelines a financial incentive to promote efficient capacity reallocations beyond simply posting capacity availability and to benefit releasing shippers via the credit to their bills. Of course, the pipeline will not be compensated if it does not find the replacement shipper, such as where the releasing shipper had a pre-arranged deal as discussed above, or where someone accepts a posted offer without the pipeline finding that new shipper. It is only appropriate for the pipeline to receive compensation when it makes an extra effort to market the released capacity, for example, when it combines two or more packages of released capacity into one, more attractive package. The administrative fee would apply regardless of whether a replacement shipper takes the released capacity since it is designed to recover the pipeline's out-of-pocket expenses in administering the capacity releasing program.

The pipeline and the participants must devise in the restructuring proceeding methods for dealing with the circumstances where more than one applicant meets the releasing shipper's price and other specifications or where an applicant makes a counter offer.

The main difference between capacity brokering as it now exists and the new capacity releasing program is that, under capacity brokering, the brokering customer could enter into and execute its own deals without involving the pipeline. Under capacity releasing, all offers *must* be put on the pipeline's electronic bulletin board and contracting is done directly with the pipeline. Nonetheless, the releasing shipper may search for someone to take its capacity both before and after the capacity is put on the electronic bulletin board. However, as stated, a capacity releasing deal cannot be consummated until after it is posted.

The main objection by commenters [128] is that pipelines will have no incentive to effect the releasing of capacity. However, the rule requires the pipeline to establish and operate a capacity releasing program. The pipeline must transfer released firm capacity to willing buyers of that capacity. Because the program will be operated in accordance with the pipeline's open-access transportation tariff, the pipeline may not refuse to provide the requested service if the shipper meets the pipeline's applicable tariff conditions. In addition, as stated above, the Commission is permitting pipelines to market released capacity and to be compensated if they take affirmative action to market the released capacity and find a replacement shipper, beyond posting the information on the bulletin board. Hence, the Commission concludes that pipelines will not act to inhibit capacity releasing.

Of course, the pipeline must continue to sell all its available firm or interruptible capacity. The pipeline must do this by putting the terms and conditions on the electronic bulletin board. It is up to customers to decide if they want the pipeline's uncommitted firm capacity the released capacity or interruptible capacity.[129] In addition, any change in the level of the pipeline's interruptible volumes due to the releasing program will be accounted for in the pipeline's next rate case when projecting interruptible volumes.

The Commission's adoption of capacity releasing for all pipelines overrules all orders issued subsequent to Order No. 436 to the extent they prohibited capacity assignment.[130]

The regulations require the pipeline to allocate released capacity to the person offering the highest rate not over the maximum tariff rate the pipeline can charge to the releasing shipper. This means that the persons seeking to obtain the released capacity can offer up to the pipeline's filed maximum rate for the service received by the releasing shipper. For example, if a releasing shipper wants to release firm capacity from the Gulf of Mexico to New York City, the maximum rate would be the pipeline's maximum rate for service from the Gulf of Mexico to New York. That is the maximum rate even if a replacement shipper only wants the releasing shipper's capacity to move gas for a shorter haul (*e.g.*, from the Gulf of Mexico to Atlanta, Georgia).

In addition, the Commission is issuing, to the extent necessary, in the new regulations, a limited blanket certificate of public convenience and necessity under NGA Section 7 to all shippers holding firm capacity rights on pipelines to allow those shippers to release their capacity pursuant to the new capacity releasing program. The purpose of this certificate is limited to allowing those shippers to release capacity to the

[126] See Inquiry Into Alleged Anticompetitive Practices Related to Marketing Affiliates of Interstate Pipelines, Order No. 497–A, 54 FR 52781 (Dec. 12, 1989), FERC Stats. & Regs. [Regulations Preambles] ¶ 30,868 at p. 31,602 (1989).

[127] *E.g.*, Initial Comments of Michigan Consolidated Gas Company.

[128] *E.g.*, Department of Energy, Public Service Commission of the State of New York, Public Utilities Commission of the State of California, United Distribution Companies, and Northern Indiana Public Service Company.

[129] For example, a customer might want annual interruptible capacity rather than firm capacity on a limited basis.

[130] *E.g.*, El Paso Natural Gas Co., 35 FERC ¶ 61,440 at p. 62,065–66 (1986), *reh'g denied*, 38 FERC ¶ 61,008 (1987) and Texas Eastern Transmission Corp. 37 FERC ¶ 61,260 at p. 61,684 (1986).

pipeline as described above. This certificate does not authorize shippers to broker or assign or release capacity as under prior certificates. Rather, new § 284.243 permits the Commission to ensure that all releases are on a nondiscriminatory basis pursuant to new § 284.243. Moreover, this will make it clear that the Commission has sufficient jurisdiction to take appropriate enforcement action if capacity is not released on a nondiscriminatory basis. As stated above, the pipeline must contract with, and bill, the replacement shipper.

Last, as stated above, the Commission is amending existing capacity brokering and other capacity assignment programs to conform to the capacity allocation regulations adopted by this rule. Capacity brokering or other assignment arrangements in effect on the effective date of a pipeline's capacity releasing program under new § 284.243 of the Commission's regulations can continue, provided the broker or assignor does not give up its capacity in the restructuring proceeding as discussed *infra*. In addition, on the effective date of the pipeline's capacity releasing program, the pipeline must contract with the holder of the brokered or assigned capacity as it would with a replacement shipper at the same price and terms and conditions of the contract between the broker or assignor and the holder of the brokered or assigned capacity. The pipeline must immediately post on its electronic bulletin board for a reasonable period the price, terms and conditions of, and names of the parties to, all such arrangements. This posting is to make those arrangements public and not for allowing other persons to make a better offer.

D. "No-Notice" Transportation Service

As discussed above, the Commission is adding § 284.8(a)(4) to its regulations to require pipelines to provide a "no-notice" firm transportation service if they are providing a "no-notice" bundled, city-gate, firm sales service on the effective date of this rule. The Commission expects the pipelines and all interested participants to craft in the restructuring proceedings the operating conditions needed to ensure that the pipelines can provide a "no-notice" transportation service pursuant to which firm shippers can receive delivery of gas on demand up to their firm entitlements on a daily basis without incurring daily balancing and scheduling penalties. This "no-notice" service will enable pipeline customers to continue to receive unnominated volumes to meet unexpected requirements caused, for example, by unexpected changes in temperature. Thus, pipeline customers will be able to receive varying volumes of gas to meet their fluctuating needs during a twenty-four hour period. So, for example, constant rate of flow requirements would not apply to prohibit delivery on demand throughout the day up to a customer's daily firm entitlement under this service. The pipeline, however, could charge reasonable imbalance penalties, for example, monthly imbalance penalties.

The pipelines must include in their tariffs filed as part of their restructuring filings, and maintain in their tariff after implementation of their restructuring proposal, all operating conditions germane to the provision of a "no-notice" firm transportation service. In addition to knowing those operational conditions, it is important for firm shippers to be aware of the component costs attributable to the "no-notice" transportation service. Only then will pipeline customers be able to make an informed choice about, for example, whether to elect "no-notice" transportation or the pipeline's other open-access, firm transportation service. The pipeline's customers need to know the differences between various services and the costs associated with those differences. Hence, the pipelines must, in the restructuring proceedings, indicate how they derived their "no-notice" and other firm transportation rates. This requires the pipelines to prepare workpapers detailing, among other things, the discrete elements of the "no-notice" transportation service rates, such as the cost of any system storage or imbalance services included within a rate. Furthermore, the pipelines must separately identify those cost components in their rate schedules filed as part of their *pro forma* tariff sheets in their restructuring filings and in future tariff filings. The Commission's aim is for pipeline customers to be able to rationally choose from a menu of pipeline services. The pipeline customers may elect "no-notice" transportation or decide to purchase other open access transportaion or other distinct services, such as contract storage or, if offered, an imbalance management service.

It is important to note that this required new "no-notice" transportation service differs from an "agency" service. The "no-notice" transportation service is a service where the pipeline customer can receive its gas on demand as discussed above. That gas may be purchased from the pipeline or from any other gas seller. The "agency" service is a service where the gas purchaser gives an agent (either the pipeline in its role as gas seller, or another gas supplier) the right to act on its behalf to arrange for pipeline services to deliver the gas. The "agency" service does not ensure "no-notice" service by the pipeline as does the new "no-notice" transportation service to be provided in addition to traditional open-access, firm transportation service. Rather, the "agency" service is a service where the gas purchaser gives an agent the right to act on its behalf in fulfilling its obligations with respect to the pipeline services elected by the gas purchaser. For example, the gas purchaser could authorize an agent to nominate its injections into the pipeline under the pipeline's traditional open-access firm transportation service or to be responsible for responding to operational flow orders to inject gas into the pipeline under the "no-notice" transportation service. However, an agent, such as a marketer, could guarantee a "no-notice" service but, unless the gas is shipped under the pipeline's "no-notice" transportation service, the agent, and not the pipeline, would be responsible for providing the "no-notice" service.

The Commission believes that all pipelines, with appropriate operational conditions, can provide a "no-notice" firm transportation service. This is because the Commission envisions the pipeline managing its unbundled system in a similar manner to its management of its bundled system, except that the place where title to gas transfers will be upstream. Indeed, at the January 22, 1992 technical conference, the pipeline industry representatives indicated that the pipelines could perform a "no-notice" firm transportation service provided the pipelines retained adequate control of the use of their facilities.[131]

The Commission will not impose or forbid any particular operational conditions at this time. The pipelines and interested participants need the flexibility to explore all aspects of how the pipelines can provide this service in light of the individual configurations of the pipeline systems. Of course, the operational conditions must be devised and implemented on a non-discriminatory basis for all shippers. Simply put, the Commission will not allow any operationally related tariff provision to undermine the quality of unbundled services the pipeline will be required to provide or to give a competitive advantage to the pipeline as a seller or to its marketing affiliate.

[131] Technical Conference Tr. 36–38.

The Commission is requiring the pipelines to provide a "no-notice" transportation service as part of its remedy in connection with concluding that the pipelines' bundled, city-gate, firm sales service contravenes NGA section 5. However, some commenters contend that the Commission's action under NGA section 5 violates NGA section 7 because the Commission lacks the authority to revoke, suspend, or adversely modify an issued and accepted certificate.[132]

NGA section 5 expressly authorizes the Commission to find that any "rate, charge, or classification" or "any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential," and requires the Commission to determine and fix the "just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force." The courts have rejected contentions that Commission action under NGA section 5 is an unlawful revocation or modification of a certificate of public convenience and necessity under NGA section 7.[133] As a court noted in an analogous situation to that presented here:

> Section 7, which vests in the Commission control over the conditions under which gas may initially be dedicated to public use, does not guarantee that the initial terms of that service will never change.[134]

Of course, "the LDC's entitlement and the pipeline's obligation [have] a legal existence independent of the contract and persist until the Commission issues formal approval of abandonment."[135] Here, the Commission is altering existing bundled sales contracts but is retaining both the LDC's entitlement and the pipeline's service obligation with respect to firm sales, if the LDC and the pipeline agree upon the price for gas, and the firm transportation of gas to the city-gate under no-notice transportation service. Conversely, in the absence of an agreement pursuant to the procedures established by this rule, a pipeline's sales service obligation will cease as of the effective date of the tariff sheets filed in compliance with this rule. See discussion, *infra*, in section IX. The Commission is changing one contract under one certificate for firm sales and embedded transportation into two contracts and two blanket certificates for firm sales and firm transportation. The existing bundled, city-gate service will be supplanted as of the effective date of the tariff sheets filed to comply with this rule. The terms under which the pipelines sell and transport gas are changed. The pipelines' certificates for individual service are, in essence, merged into or subsumed within the pipelines' blanket certificates. Thus, depending on the outcome of the negotiations, any new pipeline sales service obligation will be defined by the terms of the new contractual relationship entered into as a result of the restructuring proceeding. The pipelines' service obligation under the blanket sales certificates and contractual arrangements for unbundled sales are discussed below in section IX.A, *infra*.

The Commission is giving pipeline customers as part of its remedial action, the right to reduce their unbundled firm sales entitlements in whole or in part as a transition to the market-based gas pricing regime. This will enable the pipeline's firm sales customers to freely negotiate the quantity and price of supplies purchased from the pipeline or other gas suppliers. Those customers will, therefore, be able to take advantage of all opportunities for long-term sales contracts in a competitive market. However, this remedial action does not revoke the pipelines' authority to sell gas. It merely means that the pipelines must compete to retain their business. Last, while "the Commission has plenary authority to limit or to proscribe contractual arrangements that contravene the relevant public interests,"[136] the Commission emphasizes that a purpose of this rule is to create a regulatory environment whereby gas purchasers and gas sellers can structure their relationships as much as possible by private commercial contracts after the initial transition.

The Commission's analysis of the comments yields two interrelated operational concerns about unbundling and the "no-notice" firm transportation service. The first concern is with keeping the pipeline operational at the pressures required to provide an efficient and reliable transportation service. The second concern is that the pipeline have adequate supplies to deliver on demand. For example, CNG Transmission Corporation expressed concern about losing throughput capacity because of the impact of unbundling on deliveries through displacement.[137] Because the pipeline is operating as a transporter, its ability to effectively manage its system will depend in part on its shippers injecting gas into the mainline (packing the line) and into storage at the right place and time. While the pipeline and its shippers (or their suppliers or agents) may be able to achieve what is needed through communication, cooperation, coordination, and compromise, it may be necessary for the pipeline to retain compulsory powers where it dictates to shippers where and when to act by, for example, operational flow orders. All shippers must recognize that the action or nonaction by a single shipper may affect a pipeline's ability to serve all other shippers.

Several additional matters deserve discussion. First, the Commission recognizes that the pipeline must be able to control the operation of the system facilities, such as operation of the compressors and the performance of maintenance. The pipeline may need to enter into agreements with gas suppliers where they balance injections of their shippers and provide predetermined allocation agreements. The pipeline may have to direct shippers to inject gas at particular supply inputs at particular times to keep the line appropriately packed.[138] The pipeline may have to retain *some* storage capacity or have the right to borrow gas from contract storage, or both, to keep the system in balance and to provide this "no-notice" service.[139] The pipeline may have to

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[132] *E.g.*, PEC Pipeline Group, Associated Gas Distributors, and Baltimore Gas and Electric Company.

[133] *Wisconsin Gas Co.* v. *FERC*, 770 F.2d 1144, 1153 n.9 (D.C. Cir. 1985), *citing, Atlantic Refining Co.* v. *Public Service Commission of New York*, 360 U.S. 378, 389 (1959) *cert. denied*, 476 U.S. 1114 (1986); *Transwestern Pipeline Co.* v. *FERC*, 820 F. 2d 733, 746 (5th Cir. 1987); *cert. denied*, 484 U.S. 1005 (1988).

[134] *Wisconsin Gas Co.* v. *FERC*, 770 F.2d 1144, 1153 n. 9 (D.C. Cir. 1985).

[135] *Associated Gas Distributors* v. *FERC*, 824 F.2d 981, 1013 (D.C. Cir. 1987), *cert. denied*, 485 U.S. 1006 (1988).

[136] Permian Basin Area Rates, 390 U.S. 747, 784 (1968).

[137] Initial comments at 20. CNG states that "[d]isplacement occurs whenever gas supplies are recovered at one point on the system for redelivery at another point without a physical flow of that amount of gas along a continuous path between the two points." *Id.* n. 15. For example, CNG is concerned about its ability to ensure reliability with its current storage in the absence of its bundled sales services.

[138] For example, at the January 22 technical conference, Arkla Energy Resources emphasized that on web-like systems, the pipeline needs to retain operational control to maintain the bidirectional flow necessary in order to maintain its peak capacity. Technical Conference Tr. 71–73.

[139] As a general matter, gas in storage can be analogized to money in a bank. The customer injecting gas into storage is acting like a depositor putting money into a bank. The customer, as a "depositor", may withdraw its gas from the pipeline when it wants. (Of course, the customer's right to withdraw gas from storage is subject to operational constraints.) But the pipeline, just as a bank, may use the "deposited" gas to serve another customer in the meantime.

impose reasonable limitations on the use of storage, including conditions of injection and withdrawal, and may have to designate shippers to particular storage facilities. The pipeline and its shippers need to fashion reasonable, yet effective, methods such as penalties to deter shipper behavior inimical to the welfare of the system and other shippers. The pipeline and its shippers and interested participants may develop reasonable mechanisms to permit the borrowing of gas of one shipper by another shipper so that the pipeline can make deliveries on demand. For example, an interruptible transportation customer with gas in the system may have to allow the gas to be delivered to an LDC to meet its needs when the temperature drops unexpectedly. Once again, the Commission will require the pipeline to devise and implement all operational provisions on a nondiscriminatory basis for all shippers, without diluting the quality of unbundled services that must be offered or creating an advantage to the pipeline as seller or to its marketing affiliate.

The discussion above indicates some of the complex matters that need to be addressed by the participants in the restructuring proceedings. The Commission expects all interested parties to participate in tailoring the appropriate operational features of the pipeline's tariff. However, the Commission recognizes that those provisions may vary from pipeline to pipeline. Moreover, each provision will be scrutinized by the Commission in the compliance filing to ensure that the proposal does not, in any way, undermine the quality of transportation principle set forth above.

The requirement that a pipeline provide "no-notice" transportation service will enable a customer to receive its natural gas supplies in a fashion as reliable as the customer had been receiving under a bundled, city-gate service, with the added advantage of providing greater opportunities to purchase that supply at competitive prices. Hence, the customer will have the "best of both worlds"—reliable service and competitively priced gas. The following scenario depicts how this would happen.

Upon unbundling, the pipeline's former bundled, city-gate, firm sales customer will be entitled to purchase gas from the pipeline or from another gas supplier and to ship its gas under the new "no-notice" firm transportation service. The customer can also appoint its gas seller, whether it is the pipeline or another gas supplier, to act as its agent in dealing with the pipeline. The agent would be responsible for making all arrangements with the pipeline necessary to deliver the gas to the customer. For example, since it will be up to the customer to ensure that its supplies are capable of physical delivery, the customer or its agent would have to inject gas into the mainline and into its contract storage in conformance with the pipeline's tariff. The pipeline will then be obligated to deliver the customer's gas up to its daily contract entitlement, without penalty, even if this is above the scheduled amount. Thus, the customer's ability to just "turn on the valve," in layman's parlance, would be the same as its current ability under bundled service. This will allow the customer to meet the demand of its system as it has historically done, for example, when the weather suddenly turned cold.

Of course, the pipeline could include in its rates for the "no-notice" transportation service the costs associated with performing this service. For example, it could include the costs of managing imbalances through the use of contract gas in storage. The pipeline could also offer different daily imbalance management options based on a customer's desired tolerance above expected scheduled quantities and allowed tolerances.

The Commission concludes by reminding the industry that it is in the nation's and the industry's interest for them to arrive at legitimate and effective operational conditions which keep gas flowing and deliverable when and where needed and at the same time do not unreasonably inhibit the meeting of gas purchasers and gas sellers in a competitive market place. Again, the Commission will scrutinize all proposed operationally-related tariff provisions to ensure that they are devised and implemented on a nondiscriminatory basis for all shippers.

E. Storage

As discussed above, the Commission is requiring pipelines to unbundle the sales and transportation components of their bundled, city-gate, firm sales services to remedy the pipelines' unfair advantage as merchants of gas over other merchants. As stated, a reason for the pipelines' advantage is that, as bundled merchants, they have superior access to storage facilities. This is because, at present, an open access pipeline must make system storage available to firm shippers only on a nondiscriminatory basis to assure open access firm transportation service.[140] The Commission has not required open access pipelines to make storage available on an open access contract basis so that shippers may store their own gas.[141]

The pipelines' superior rights with respect to access and control of storage provide them with several advantages over other gas merchants with no access to storage for their gas. First, the pipelines can use storage to implement seasonal supply management where they purchase gas during offpeak periods. This enables the pipelines to cut gas costs by buying gas when it is less costly during offpeak periods. Second, the pipeline can use storage as a supplement to transmission capacity. This occurs when mainline transmission capacity is less than the pipeline's firm obligations, with the difference delivered out of downstream storage close to the pipeline's market areas. Last, pipelines can use storage to maintain a constant flow of gas by taking supplies from, or diverting gas to, storage. This enables them to manage their system in response to rapidly changing customer demands for gas. The above-described uses of storage give the pipelines an unfair advantage over other gas sellers because non-pipeline shippers do not have the flexibility to provide fully a sales service which meets gas purchasers' peak needs.

The Commission's unbundling of pipeline sales and transportation services means that pipelines with downstream storage will need it *only* to fulfill their obligations with respect to system management (load balancing) and "no-notice" transportation. Because storage is now defined as transportation, under § 284.1(a), which must be unbundled from sales, the pipeline itself may not retain, or hold, any storage capacity downstream of the place where it unbundles in connection with the providing of any of its own sales services. Hence, the pipelines with downstream storage should have storage available to sell to transportation customers on an open access, nondiscriminatory, contract basis. This will enable open access transportation customers to buy gas and store it for future use. This will enable

[140] Order No. 436, *supra* n.2, at p. 31,507. System storage includes facilities owned and used by the pipeline to store its own gas for operational reasons such as for balancing or for use in lieu of transportation capacity.

[141] Some open access pipelines have applied for blanket certificates to provide firm and interruptible open access storage services. *E.g.*, Texas Eastern Transmission corp., 53 FERC ¶ 61,424 (1990); Northwest Pipeline Corp., 50 FERC ¶ 61,341 (1990) and ANR Pipeline Co., 46 FERC ¶ 61,339 (1989), *reh'g and clarification granted part and denied in part*, 49 FERC ¶ 61,046 (1989).

all shippers to more effectively manage their gas supply and procurement programs.

In addition, shipper access to upstream storage is an important factor in securing equality for all gas suppliers. For example, this storage is valuable to gas purchasers that want to buy gas off peak at cheaper prices and store it for later use. Preventing access to upstream storage gives the pipelines, as sellers, an undue competitive advantage over other gas merchants and conflicts with the goal of open access to maximize the benefits of competition by requiring all gas supplies to be treated and transported on equal terms.

The Commission is amending part 284 to require an interstate pipeline to offer access to its storage facilities on a firm and interruptible open access contract basis as part of its open access transportation. This is accomplished by amending § 284.1(a) of the Commission's regulations to define transportation as including storage. As amended, § 284.1(a) would read: " 'Transportation' includes storage, exchange, backhaul, displacement or other methods of transportation." Storage, therefore, would be included within the nondiscriminatory access and other requirements of part 284 for interstate pipelines.[142] Intrastate pipelines would be permitted, but not required, to offer open-access, contract storage under subpart C of part 284 of the Commission's regulations. The Commission is also making minor conforming changes to the existing reporting requirements contained in part 284. Pipelines providing blanket open-access storage services under part 284 will be required to submit reports to the Commission after the end of each injection and withdrawal season, as is currently required of pipelines holding blanket storage certificates. However, the Commission will not require pipelines to file duplicative self-implementing transaction reports.

Pipelines would have to provide access to storage on a firm and interruptible basis for all shipper gas without regard to the seller in a manner that is not unduly discriminatory. The pipeline would be required to offer the open access storage on a basis that is unbundled and not in any way tied or linked to the storage customer's purchase of any particular type of sales service. However, the pipeline may offer both transportation and storage services as part of the service to perform its "no-notice" transportation service required *supra*, but the pipeline must also make storage available on a stand-alone basis. Of course, a shipper purchasing open access contract storage would be responsible for arranging to put its own gas in its firm storage space so that it can be withdrawn when needed.

Commenters raise concerns about the allocation of storage capacity, the pipelines' needs to retain storage capacity for system management, the rights of current holders of contract storage capacity, and whether converting customers under the new regulations should have priority for storage capacity.[143]

The Commission will not impose a generic allocation method for storage capacity. The only requirement imposed in the regulation is that storage capacity must be allocated on an even, nondiscriminatory basis among all shippers without regard to the seller of the gas. For example, the pipeline may hold an open season for initial allocation of storage capacity. Or, storage can be allocated on a pro-rata basis. This should be addressed in each restructuring proceeding. With respect to storage capacity upstream of the place of unbundling, the pipeline will be able to continue to retain some of that capacity for its own use as a seller. The allocation of this capacity between the pipeline, for use to make sales, and others, of course, must be done on a non-discriminatory basis and the costs associated with the upstream storage capacity allocated to the pipeline must be recovered by the pipeline solely as part of its market-based sales rate. In addition, the pipeline must subject itself to all tariff terms and conditions applicable to holders of firm upstream storage capacity (*e.g.*, injection and withdrawal requirements).

Any allocation of storage capacity, however, must take into account pipeline capacity needs for load balancing and system management and the need to reserve some level of storage capacity for the pipeline or for shippers in connection with the pipeline's "no-notice" transportation service. The reservation of storage capacity for these transportation services is different from the pipeline's reservation of storage capacity to make sales. The reservation of storage capacity for transportation functions should be addressed in the restructuring proceedings.

All current holders of contract storage capacity will retain that capacity under current contractual provisions and are not subject to the pregranted abandonment provisions discussed, *infra*. However, as stated above, firm storage capacity held by downstream pipelines on upstream pipelines must be made available to the downstream pipeline's firm shippers under new § 284.242. Moreover, the downstream pipelines, like all holders of firm storage capacity, can release their upstream storage capacity under § 284.243.

If the pipeline has storage capacity remaining after it has sold contract storage and retained any system storage needed for system management and load balancing purposes to perform its "non-notice" transportation service, or to make sales upstream of the unbundling point, the pipeline can seek to recover costs associated with the "stranded" storage capacity as a transition cost, as discussed, *infra*.

Associated Gas Distributors argues that "the final rule should expressly provide that interruptible storage capacity should *not* be made available when that capacity is already held by another shipper." [144] The Commission concludes that pipelines should not limit the availability of interruptible storage unless it is shown in a restructuring proceeding that a particular limitation is operationally warranted on a particular pipeline system.

The NOPR proposed to amend § 284.1(a) only with respect to interstate pipelines. Houston Pipe Line Company asks that the final rule be clarified to make clear that intrastate pipelines, while not required to provide open access storage service, are nevertheless permitted (or are not denied the opportunity to offer) NGPA section 311(a)(2) storage services. The Commission has clarified this by amending § 284.1(a) so that it applies to both interstate and intrastate pipelines.

F. Market Centers and Pooling Areas

1. Market Centers

The Commission is adopting this rule in order to facilitate the meeting of gas purchasers and gas sellers in a national gas market.[145] Market centers may, in certain areas, create additional meeting places for gas purchasers and gas sellers. These inter-pipeline market centers would allow gas from production areas attached to different pipelines to meet where the pipelines

[142] *E.g.*, storage rates would be designed pursuant to Part 284 as amended by this order. See also n.141, *supra* for examples of previously certificated open-access storage services.

[143] *E.g.*, Citizens Gas and Coke Utility, Gas Company of New Mexico, Long Island Lightning Company, New England Gas Distributors, Peoples Natural Gas Company, Washington Gas Light Company, and INGAA.

[144] Initial Comments at 21 (emphasis in original).

[145] See the discussion of market centers in Importance of Market Centers, Office of Economic Policy, FERC (Washington, DC), August 21, 1991.

intersect to create a market for gas purchasers from different market areas. The Commission believes that market centers should develop naturally and, therefore, will not mandate market centers. However, as stated above, the Commission is requiring in new §§ 284.8(b)(5) and 284.9(b)(5) that there must be nothing in a pipeline's tariff that inhibits the development of market centers.

In addition, as discussed below, the Commission is amending its part 284 regulations to require pipelines to permit shippers to receive gas into the system and to deliver gas from the system anywhere receipt and deliveries are possible. This should facilitate both the development of market centers and the use of capacity releasing.

2. Pooling Areas

The Commission also believes that the meeting of gas purchasers and gas sellers can be facilitated by the creation of production area pooling areas on individual pipelines. Production area pooling areas may facilitate the aggregation of supplies by all merchants. The pooling areas may either be places where title passes from the gas merchant to the shipper or they may be places where aggregation and balancing and penalties are determined ("paper" pooling areas). The Commission will not mandate pooling areas, but will not permit actions that inhibit their development.

At whatever place unbundling occurs,[146] and whether or not a pipeline establishes pooling areas, the Commission believes that pipelines should consider entering into "operational balancing agreements" with other gas merchants to allow them to balance, in the aggregate, for all of their gas purchasers shipping on the pipeline. The Commission also wants the pipelines and their customers and interested parties to consider in the restructuring proceedings the need for appropriate equipment to accurately monitor and measure injections into the system on a timely basis. It may not be cost-effective on some pipeline systems to install the necessary equipment. In those cases, the pipelines should consider allowing other gas merchants to provide the pipeline with pre-determined allocation plans for the merchant's gas. The pipeline should report on this matter in its restructuring filing.

[146] The point of unbundling should be located as far upstream as possible.

G. Flexible Receipt and Delivery Points

Section 284.221(g) of the Commission's regulations gives pipelines the authority to permit flexible receipt points for receipts of gas volumes into their systems.[147] In implementing that section, the Commission has required that firm shippers must have flexibility in changing firm receipt points and in using all available receipt points on an interruptible basis.[148] This flexibility includes the right to bump interruptible shippers on reasonable notice.[149]

Section 284.221(h) of the Commission's regulations, also promulgated by Order No. 436, gives pipelines the authority to permit flexible delivery points for deliveries of gas volumes from their systems.[150] However, the Commission subsequently concluded that, in most cases, flexibility delivery points were inconsistent with the Commission's requirement of identification of the recipient of the gas in each transaction.[151] The Commission's concern was that flexible delivery points could lead shippers to broker capacity and thereby abuse the first come, first served principle for allocating mainline capacity. However, in Columbia Gas Transmission Corp., the Commission permitted Columbia to institute flexible delivery points because Columbia's firm sales customers had conjunctive billing rights where the customer could accept delivery at multiple delivery points.[152] Recently, in Transwestern Pipeline Co., the Commission approved a proposal establishing flexible receipt and delivery points on Transwestern's system.[153]

The Commission concludes that it should modify its current policies with respect to flexible receipt and delivery point policies to provide for more flexibility. First, the Commission will require pipelines to give firm shippers flexible delivery points in their distribution areas in the same manner as it gives firm shippers flexible receipt points in the production areas. Firm shippers will have the right to change firm delivery points and to use other delivery points on an interruptible basis without losing their priority for firm service.[154] The allocation of capacity of receipt and delivery points will be determined in the restructuring proceedings and set out in the pipeline's tariff as required by new § 284.14(b)(1)(v) of the Commission's regulations. Second, the Commission will expand firm shippers' rights to receipt and delivery points to include the right to receive gas from any person at any place on the system and the right to deliver gas to any person at any place on the system on a firm basis with the flexibility to change firm receipt and delivery points and to use all delivery points on an interruptible basis. Of course, receipt and delivery points must be within the firm transportation capacity to which the shipper is entitled, and for which it pays. So, for example, an LDC in a downstream region of the country could arrange to deliver gas to an LDC or an industrial in an upstream region,[155] but conversely an LDC in an upstream region could not arrange for delivery in a downstream region.

The Commission believes that these policies are necessary to promote maximum efficient usage of the pipeline systems. For example, flexible receipt and delivery points are necessary to the continued development of market centers were pipelines interconnect. In addition, both flexible rights to receipt and delivery points and distribution area delivery point flexibility are necessary to achieve a broad and meaningful firm capacity releasing program. The Commission believes that the new firm capacity releasing program can operate in a nondiscriminatory manner alongside the pipeline's allocation of its own available capacity on the electronic bulletin board as discussed above. The new capacity releasing program and flexible delivery point policy mean that a shipper will not lose its firm capacity by changing firm delivery points in order to permit another entity to ship gas through the releasing shippers' firm capacity. Any Commission orders that indicate that a shipper would lose its right to firm mainline capacity by changing firm delivery points are overruled.[156]

H. Curtailment

The Commission's current curtailment policy is that the NGPA Title IV system of curtailment priorities for certain end users applies to curtailments that result from a shortage of pipeline gas

[147] 18 CFR 284.221(g).

[148] Northwest Pipeline Corp., 46 FERC ¶ 61,106 at p. 61,428 (1989).

[149] Williams Natural Gas Co., 56 FERC ¶ 61,281 at p. 62,095 (1991).

[150] 18 CFR 284.221(h).

[151] El Paso Natural Gas Co., 35 FERC ¶ 61,440 at p. 62,066 (1986), reh'q denied, 28 FERC ¶ 61,008 (1987).

[152] 52 FERC ¶ 61,041 at p. 61,193 (1990).

[153] 58 FERC ¶ 61,299 (1992).

[154] This refers to existing capacity at the distribution area delivery points.

[155] The issue of industrial customers potentially by-passing an LDC is discussed below in the transition cost section.

[156] *E.g.*, El Paso Natural Gas Co., 35 FERC ¶ 61,440 at p. 62,066 (1986), *reh'q denied*, 38 FERC ¶ 61,008 (1987) and Texas Eastern Transmission Corp. 37 FERC ¶ 61,260 at p. 61,684 (1986).

supplies [157] and not to curtailments that result from a shortage of transportation capacity.[158] As the Commission stated in Order No. 436:

> [G]as being transported normally should not be subject to curtailment by the pipeline at all, because it would be the pipeline's system supply, not the shippers' gas, that would be curtailed.[159]

Accordingly, when a pipeline's gas supplies are scarce, the pipeline should curtail its sales customers without affecting its transportation customers.

With respect to capacity-related curtailments, the Commission has routinely authorized pipelines to have transportation curtailment plans which differ from their sales curtailment plans, and has specifically approved transportation curtailment plans which are based on *pro rata* allocations of capacity.[160] The Commission has, however, permitted parties to agree to an end-use specific transportation capacity curtailment plan.[161]

The NOPR proposed to continue the existing policies with respect to supply and capacity curtailment.

The commenters raise two similar points. Some would apply the NGPA Title IV priorities to capacity curtailment.[162] Others argue that Title IV priorities should not apply to supply curtailment in an unbundled environment.[163] Both arguments would result in similar treatment for all gas by either applying the NGPA Title IV priorities in all curtailment circumstances or not applying the priorities in any circumstances. In the alternative, Elizabethtown would require pipeline sales customers to exhaust other sources of gas supply and agree to compensate the LDCs suffering more than pro rata curtailment. The Industrial Group would allow the pipelines' customers to fashion emergency plans in the event of *force majeure* capacity curtailment to prevent LDCs from having to cut-off their customers.

The Commission agrees with the commenters' theory that to put pipeline sales and sales by others on an equal footing requires the equal treatment of all gas for both supply and capacity curtailment purposes. However, as stated in Transcontinental Gas Pipe Line Corp.,[164] "[u]ntil Congress changes the [NGPA], the statutory priority [for pipeline sales] must be observed." [165] Thus, Title IV of the NGPA must continue to apply to sales only. Moreover, the Commission does not believe it is appropriate to require high priority customers to exhaust other sources of gas supplies before application of the NGPA Title IV priorities to pipeline sales.[166] With respect to the comments about compensation among pipeline customers in the event of a supply curtailment under the Title IV priorities, [167] the Commission will not prevent, and indeed encourages, such inter-customer agreements. In addition, it may be possible for sales customers of pipelines to reflect their Title IV priorities in their negotiated pipeline supply charges.

However, with the unbundling of pipeline sales from transportation, the NGPA Title IV priorities will only apply to a narrow category of gas supplies—pipeline sales near the wellhead. After the point of sale, all gas will move through the pipeline as transportation gas and will not be required to be curtailed by the NGPA Title IV categories. Rather, the curtailment of deliveries owing to capacity curtailment must be done on a *pro rata* basis or some other basis developed by the parties in the restructuring proceedings.[168] However, the rules and allocation priorities of transportation capacity curtailment plans must be set forth clearly and specifically in the pipelines' tariffs.

The Commission urges the parties to develop tariff mechanisms that provide flexibility, because at the time a need for capacity curtailment arises it may not be possible to identify ownership of the gas or to control its flow. Hence, it is expected that gas will continue to flow to those who need it for heating or other important needs without regard to any *pro rata* curtailment plan. Therefore, the participants in the restructuring proceedings should address ways to deal with the emergency shortages due to capacity constraints. For example, a pipeline's transportation customers may be willing to release capacity under the capacity releasing mechanism or to sell gas if need be upon reasonable compensation.[169] In any event, the pipelines must file with the Commission, as part of their tariffs, their supply and capacity (transportation and storage) curtailment plans in sufficient detail to accommodate the interests of all shippers. The Commission retains sufficient authority under this rule to prescribe accounting or allocation procedures if needed in the future.

Whether in connection with capacity curtailment or otherwise, the Commission is concerned about allegations that pipelines have permitted the diversion of a customer's gas (*e.g.*, an industrial) to another customers (an LDC).[170] While some commenters suggested the Commission adopt rules on gas accounting matters,[171] the Commission believes it unwise to mandate particular solutions. However, the Commission will require the parties to the restructuring proceedings to address the issue of the diverting of gas owned by one shipper to another shipper. The participants should explore the possibility of flow control by the pipeline to prevent customers from taking gas. In addition, participants must address the need for and cost feasibility of accurate and timely measurement equipment so that pipelines know how much gas is in the system, whose gas it is, and who is taking delivery of the gas. Pipelines will be allowed cost recovery for purchasing and installing such equipment in their NGA section 4 rate cases, subject to prudence reviews. As indicated above in connection with capacity curtailment, the participants should also explore the need for authorized diversion where the gas can be diverted in specific circumstances with reasonable compensation.

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[157] 15 U.S.C. 3391–4 (1988); El Paso Natural Gas Co., 54 FERC ¶ 61,316 at p. 61,954 (1991).

[158] *E.g.*, Order No. 436, supra n.2, at p. 31,515; Order No. 436–A, *supra* n.2 at pp. 31,652–53; *Cf., Sebring Utilities Com'n* v. *FERC*, 591 F.2d 1003 (5th Cir. 1979), *cert. denied*, 444 U.S. 879 (1979).

[159] Order No. 436, *supra* n.2, at p. 31,515; Order No. 436–A, *supra* n.2 at pp. 31,652–53.

[160] *See* Texas Eastern Transmission Corp., 37 FERC ¶ 61,260 (1986); Southern Natural Gas Co., 41 FERC ¶ 61,218 (1987).

[161] Florida Gas Transmission Co., 51 FERC ¶ 61,309 (1990); United Gas Pipe Line Co., 46 FERC ¶ 61,314 *order on reh'g*, 49 FERC ¶ 61,096 (1989). Those cases involved settlements where the parties agreed to the curtailment plan. In United, the Commission did find that the capacity curtailment provision was in compliance with the requirements of Title IV of the NGPA. However, the effect of that order was to approve a specific settlement agreement, and any inference that the NGPA mandates end-use specific curtailment plans is misplaced.

[162] *E.g.*, Agricultural Minerals Corporation and the Fertilizer Institute.

[163] *E.g.*, Elizabethtown Gas Company.

[164] 57 FERC ¶ 61,345 (1991).

[165] *Id.* at p. 62,117.

[166] *Id.* n.57, where the Commission rejected Elizabethtown's request that gas purchasers seeking NGPA Title IV relief take certain remedial action first.

[167] *E.g.*, Elizabethtown Gas Company and the Process Gas Consumers Group, American Iron and Steel Institute, Chemical Manufacturers Association, Georgia Industrial Group, and the Association of Businesses Advocating Tariff Equity (Industrial Groups).

[168] See n.160 and 161, *supra*.

[169] For example, see the Industrial Group's proposal in its response to the Commission's Notice of Technical Conference in Docket No. RM91–11–000.

[170] See the Staff Summary of December 1989 Curtailment Survey Response, Docket No. TC90–8–000, Nov. 1, 1990.

[171] *E.g.*, the IPAA.

VIII. Rate Design

A. Introduction

As part of the Commission's actions to improve the competitive structure of the natural gas industry, the Commission will adopt the proposed rule and require a generic change in pipeline transportation rates to eliminate potential competitive distortions in pipeline rate structures. Specifically, the Commission's task is to determine the appropriate level of fixed transportation and storage costs to be recovered through the reservation charge [172] and usage charge in designing pipeline rates.[173] This determination is known as cost classification and is one part of the ratemaking process described below.

The Commission engages in five steps in fashioning a pipeline's rates for its jurisdictional customers. The first task is to determine the pipeline's overall cost of service.[174] The second task is to functionalize the pipeline's costs by determining to which of the pipeline's various operations or facilities the costs belong. This step is known as functionalization and mainly turns on the particular characterization of the pipeline's facilities as production area, transmission, or storage facilities. The third task is to categorize the costs assigned to each function as fixed costs (which do not vary with the volume of gas transported) or variable costs, and to classify (*i.e.*, assign) those costs to the reservation and usage charges of the pipeline's rates. This step is known as classification. The fourth task is to apportion the costs classified to the reservation and usage charges among the pipeline's various rate zones and among the pipeline's various classes of jurisdictional services. This step is known as allocation. The fifth task is to design each service's rates for billing purposes by computing unit rates for each service. This step is known as rate design. The entire process is known as ratemaking.

The instant rule will not address functionalization, which is mainly important in determining whether facilities are jurisdictional or nonjurisdictional.[175] The Commission will continue to functionalize between transportation and gathering based on the modified *Farmland* test.[176] The present focus is on classification as it relates to allocation and to the designing of the actual rates.

B. Background

The Commission uses the cost classification aspect of the ratemaking process to achieve policy goals that are pertinent to current conditions. Because conditions change over time, the Commission's goals change and the weight given to various goals also changes. This balancing of goals is a matter of judgement and is not an exact science.[177]

Frequently, however, the Commission has emphasized one particular goal in its ratemaking. That goal is to design pipeline rates in light of competition. This has involved the shifting of costs from the commodity to the reservation charge to keep pipeline rates competitive. For example, in 1965, the Commission approved rates that put ninety-six percent of a pipeline's fixed costs in its reservation charge to take into account competition from coal.[178] After the curtailment era, in 1983, the Commission first adopted the modified fixed variable (MFV) method in recognition of the annual underutilization of pipeline facilities.[179] MFV also was devised to help pipelines sell gas by moving all fixed costs except for return on equity and related taxes to the reservation charge.[180] In almost all cases, MFV reduced the pipeline's fixed costs included in its commodity charge compared to the fixed costs included in the commodity charge under the previously used *Seaboard* [181] or *United* methods.[182] MFV, therefore, was adopted in pursuit of the goal of competition by lowering pipeline sales commodity charges to enable gas to compete effectively with alternative fuels such as oil.

The Commission again emphasized the need for competitive rates when it adopted Order No. 436.[183] Section 284.7(c) of the Commission's regulations, promulgated by Order No. 436, sets forth the Commission's rate objectives in designing maximum rates for both peak and offpeak periods. In addition to rationing capacity during peak periods,[184] Section 284.7 states that "rates for firm service during off-peak periods and for interruptible service during all periods should maximize throughput." [185] In addition, Section 284.7(d)(5) authorized pipelines to discount their transportation rates below the maximum rate in order to adjust the price to meet competition from competitive fuels and from other pipelines.[186]

The Rate Design Policy Statement, while emphasizing the possible need to ration capacity, also recognized the importance of maximizing throughput in its discussions of discounted rates and rates for interruptible transportation service. In *Panhandle Eastern Pipe Line Co.*, Opinion No. 369,[187] the Commission refined its approach to the rationing capacity and maximizing throughput goals by retaining MFV for cost allocation purposes because there was no need to ration capacity on Panhandle's system,[188] but adopted the straight fixed variable (SFV) for rate design (billing) purposes because of the need to put all fixed costs in the demand charge to maximize Panhandle's throughput.[189]

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[172] Section 284.8(d) of the Commission's regulations permits pipelines to charge a reservation fee. The Commission will here refer to reservation charge rather than demand charge even when the discussion relates to the firm sales demand charge.

[173] The usage charge is also referred to as the commodity charge. However, usage is the correct term to use in connection with transportation, rather than sales, rates.

[174] The pipeline's cost of service is the total revenues needed to cover the pipeline's operations, including a just and reasonable return on its rate base.

[175] *See, e.g.*, Trunkline Gas Co. 58 FERC ¶ 61,240 (1992) and Interstate Natural Gas Pipeline Rate Design, 56 FERC ¶ 61,086 (1991).

[176] Farmland Industries, Inc., 23 FERC ¶ 61,063 (1983) and Amerada Hess Corp., *et al.*, 52 FERC ¶ 61,268 (1990).

[177] *Colorado Interstate Gas Co.* v. *FPC*, 324 U.S. 581, 589 (1945) ("Allocation of costs is not a matter for the slide-rule. It involves judgement on a myriad of facts.")

[178] *E.g.*, *Fuels Research Council, Inc.* v. *FPC*, 374 F.2d 842 (7th Cir. 1967) (The court affirmed the Commission's deviation from the Seaboard (see *infra*) method by putting 96 percent of fixed costs in the demand charge over the objection of coal associations.).

[179] Natural Gas Pipeline Company of America, 25 FERC ¶ 61,176 (1983), *order on reh'g*, 26 FERC ¶ 61,203 (1984), *aff'd in relevant part*, Northern Indiana Public Service Co. v. FERC, 782 F.2d 730 (7th Cir. 1986).

[180] Future references to fixed costs are to fixed transmission and storage costs. Storage will be unbundled from transportation and separately charged. However, some storage may be retained by the pipeline for its balancing and system management operations associated with transportation and for its no-notice transportation service.

[181] Atlantic Seaboard Corp., 11 FPC 43 (1952) (Fifty percent of fixed costs recovered in the commodity charge).

[182] United Gas Pipe Line Co., 50 FPC 1348 (1973), *aff'd sub nom.*, Consolidated Gas Supply Corp. v. FPC, 520 F.2d 1176 (D.C. Cir. 1975) (Seventy-five percent of fixed costs recovered in the commodity charge).

[183] See n.2, *supra*.

[184] "Rates for service during peak periods should ration capacity." 18 CFR 284.7(c)(1).

[185] 18 CFR 284.7(c)(2).

[186] Order No. 436, *supra* n.2, at pp. 31,543–545.

[187] 57 FERC ¶ 61,264 (1991).

[188] *Id.* at p. 61,843.

[189] *Id.* at p. 61,827–30.

C. Discussion

The Commission has discussed above in detail the evolution of the natural gas industry from a regulated, interstate, sales for resale industry with LDCs purchasing gas at the city-gate to a decontrolled gas market with gas sold in the production area and transported to the city gate under part 284 open access transportation.[190] The Commission is here adopting regulations to ensure that all gas supplies are moved to market on even terms. The Commission is adopting these regulations in order to promote competition among gas sellers (including the pipelines as merchants) in a now national gas market to ensure consumers access to adequate supplies of clean and abundant gas at reasonable prices. The Commission's task is to analyze cost classification, in light of the goals discussed in this order. The appropriate cost classification method used to allocate costs and design rates should in no way inhibit the creation of a national gas market of efficient gas merchants as envisioned by Congress in enacting the Decontrol Act. Ratemaking, like transportation terms and conditions, should comport with the goal that all gas should be shipped on even terms.[191]

The first question is whether the pipelines' currently effective cost classification methods will inhibit the goal of the development of a competitive, national gas market and, therefore, do not comport with the goals set forth in this order or with Congress' goals in enacting the Decontrol Act. In particular, the inquiry is whether the pipelines' current methods distort the gas purchaser's decision because the transportation usage charges vary in the amount of fixed costs included in each pipeline's transportation usage charge. Because the currently effective cost classification method used by most pipelines is MFV, this order will discuss the instant issue with reference to MFV. However, the following discussion and conclusion about MFV applies equally to other methods that recover fixed costs in the usage charge.

Pipelines have differing amounts of fixed costs in their usage charges because those fixed costs (return on equity and related income taxes) are determined by reference to revenue requirement criteria that differ on each pipeline. The portion of the revenue requirement for the return on equity depends on the size of a pipeline's rate base, the pipeline's ratio of equity to total capital, and the allowed rate of return on equity. Because pipelines have rate bases that vary according to their originial costs and how much they have been depreciated, and because pipelines have different capital structures and allowed rates of return on equity, the pipelines have different amounts of fixed costs in their usage charges under MFV.[192] Moreover, MFV could bias the debt-equity ratio because pipelines can increase their debt component to lower their usage charges for competitive reasons.

This situation of differing levels of fixed costs in pipeline usage charges can hinder competition between gas sellers at the wellhead because competition is not based on the seller's costs and therefore on their ability to compete directly with each other. Rather, competition for sales customers is influenced by the fixed costs in the pipeline transportation usage charges. For example, producers in different fields that compete for market share via different pipelines will often have their competitive positions in that market affected by the amount of fixed costs in the pipelines' respective transportation usage charges and not by the producers' own costs and efficiencies in producing gas. The MFV cost classification method results in the shipment of gas on uneven, rather than on even, terms and will inhibit the development of a national market which "will yield lower prices and more abundant supplies" by "over time forc[ing] the evolution of a set of lowest-cost producers" as envisioned by Congress in decontrolling the price of gas at the wellhead and in the field.[193] Accordingly, unless the Commission permits otherwise, as described below, the Commission concludes that MFV is not in the public interest, unreasonably hinders competition among gas sellers, and is unjust and unreasonable under NGA Section 5.

The Commission here is addressing cost classification for both cost allocation and rate design (billing) purposes. This means that the Rate Design Policy Statement no longer will be applicable to apportioning costs to the reservation and usage charges. However, the Rate Design Policy Statement still will be applicable to other matters, such as the determination of rates for interruptible transportation, the discounting of rates, and the requirement that rates "reasonably reflect an material variation in the cost of providing the service due to * * * [t]he distance over which the transportation is provided." [194]

Specifically, the Commission is amending Section 284.8(d) of the regulations to require pipelines to recover their transportation costs under the straight fixed variable (SFV) method of assigning all fixed costs related to transportation to the reservation charge. The Commission, however, will not rigidly preclude the pipeline, its customers, and interested state commissions, producers, marketers, brokers, end-users, and others from agreeing to an alternative method that deviates from SFV and may be appropriate to that particular pipeline system. If the parties affected by a pipeline's rate design agree to a different method, the Commission will consider giving effect to the parties' agreement. However, to the extent a pipeline's rates deviate from SFV, the Commission will carefully consider the arguments of those parties [195] proposing the deviation as well as the parties opposing the deviation. Thus, while a single party cannot preclude the Commission from considering a deviation from SFV, any party (or parties) advocating something other than SFV carries a heavy burden of persuasion. The language in § 284.8(d) of the regulatory text implements this approach and ensures that the Commission will utimately resolve this issue.

The Commission believes that requiring SFV comports with and promotes Congress' goal of a national gas market as discussed above and goes hand-in-hand with the equality principle. Under SFV, all gas merchants would be able to compete in a national market without regard to fixed transportation costs included in the usage charge.[196] This approach is as essential to the shipment of gas on even terms as is equality in the quality of service with respect to gas transportation. SFV would, therefore, maximize the benefits of wellhead decontrol by increasing the nationwide competition among gas merchants

[190] In 1990, transportation amounted to 79 percent of the total gas delivered for market by pipelines. INGAA November 1991 paper, *supra*, Table A-1.

[191] At times, the issue has been framed in the context of competition between Canadian and domestic gas. See Opinion No. 357, Iroquois Gas Transmission System, L.P., *et al.*, 53 FERC ¶ 61,194 at pp. 61,712 n.91 (1990) and Tennessee Gas Pipeline Co., 51 FERC ¶ 61,113 (1990) (NIPPS II).

[192] The more equity a pipeline has in its capital structure, the more return and related taxes will be in the usage charge.

[193] H.R. Rep. No. 29, *supra*, at p. 7.

[194] 18 CFR 284.7(d)(3).

[195] Parties include, among others, pipelines, producers, marketers, brokers, LDCs, state commissions and agencies, and end-users, such as industrials and gas-fired electric generators.

[196] Only a small amount of variable costs (such as fuel) would be in the firm transportation usage charge. Interruptible transportation rates will continue to be determined on a case-by-case basis under the Rate Design Policy Statement. With unbundling, the role of interruptible transportation should be diminished.

(including pipelines). This should result in head-to-head, gas-on-gas competition where the firm transportation rate structure is not a potentially distorting factor in the competition among merchants for gas purchasers at the wellhead and in the field. This merchant-to-merchant competition should help to achieve Congress' intent in passing the Decontrol Act to "over time force the evolution of a set of lowest-cost producers." [197] This "will yield lower prices and more abundant supplies" and benefit all consumers of gas.[198]

Moreover, the Commission's adoption of SFV should maximize pipeline throughput over time by allowing gas to compete with alternate fuels on a timely basis as the prices of alternate fuels change. The Commission believes it is beyond doubt that it is in the national interest to promote the use of clean and abundant natural gas over alternate fuels such as foreign oil.[199] SFV is the best method for doing that. As discussed above, using cost classification to design rates to influence the consumption of gas is a traditional regulatory technique of the Commission. For example, the Commission has removed costs from the commodity charge to enable pipelines to meet competition for fuel switching customers from coal.[200] And, indeed, the Commission adopted MFV in the context of competition from oil. The Commission finds it appropriate to use that technique again in the current circumstances.

D. Comments on the NOPR's Proposal

The NOPR proposed to adopt SFV for cost allocation and rate design. A few commenters support the NOPR's proposal to mandate the use of SFV generically.[201] More commenters support SFV as a method to be implemented on a case-by-case basis.[202] A number of LDCs and state commissions oppose SFV.[203] Their objections fall into two categories. They first argue that the Commission has not established that MFV is anticompetitive. In that vein, they argue that gas purchasers base their gas purchasing decisions on total costs and not only on incremental costs as assumed by the Commission. They also argue that SFV conflicts with other rate design goals. In that vein, they question the impact of SFV on pipeline incentives to enhance service reliability, maintain or maximize throughput, for example, in pipeline-to-pipeline competition, and control costs and the construction of facilities. In addition, they express concerns about the shifting of cost of low load factor customers and about the possibility that LDCs will be forced to reduce their contract demand levels and their ability to reliably serve their customers.

E. Discussion of Comments

1. Mitigation of Cost Shifts

As stated above, commenters express concerns about the shifting of costs to low load factor customers and about the possibility that LDCs will be forced to reduce their contract demand levels and their ability to reliably serve their customers. The Rate Design Policy Statement recognized the possible need for pragmatic adjustments in the event a particular method leads to undesirable or inequitable results, and required administrative law judges to "consider and articulate the impacts (benefits and detriments) of the various rate design proposals on the participants, on the various segments of the industry, and on classes of customers." [204]

The Commission recognizes that the use of SFV, without any adjustments, could result in cost shifting among customer classes. The Commission will require each pipeline to file the information necessary to determine whether mitigation measures are necessary. Accordingly, each pipeline must include in the compliance filing required by this rule a comparison of the revenue responsibility of each customer class, as they have been historically defined, for the unbundled services under (1) the pipeline's last approved cost classification method for cost allocation and rate design and (2) the SFV cost classification method for cost allocation and rate design. If the comparison shows that adopting SFV for cost allocation and rate design will result in a 10 percent or greater increase in revenue responsibility for any customer class, the Commission will require the pipeline to develop and implement a plan to phase-in any such rate increase over no more than four years. The Commission is establishing a bright-line test here for deciding whether cost shifts caused by the switch to SFV must be mitigated. This test applies only to cost shifts due to the change to SFV. Rate changes attributable to other aspects of this rule are not to be considered in determining whether a cost shift is 10 percent or greater.

The pipeline must include in the compliance filing a plan for phasing-in the cost shifts due to SFV over no more than a four year period. This is a one-time mechanism that will automatically terminate no later than four years after the Commission accepts the pipeline's filing in compliance with the final rule. Potential phase-in methods could include use of a one-part volumetric rate or seasonal contract entitlement levels for small customers, creation of new customer classes based on load factor ranges, or creation of new customer classes on that or another basis in order to continue the use of MFV for cost allocation and SFV for billing.

Unless the Commission allows a pipeline to use a method other than SFV, in requiring this phase-in, the Commission does not intend to delay implementation of SFV. In addition, SFV must be used for billing purposes even if a method of mitigating cost shifts is used, unless the Commission permits a pipeline to use a method other than SFV as its approved method of cost classification. The Commission's objective is to provide a reasonable period in which a pipeline's customers can adjust to the new cost classification methodology. The Commission will not mandate any specific type of phase-in plan or requirement at this time. However, as stated, the phase-in plan must be included in the compliance filing required under new § 284.14. Finally, the Commission will not accept any mitigation proposal that hinders mandatory unbundling and the Commission's movement towards the use of SFV.

Some commenters argue that the Commission should permit firm transportation customers to reduce their contract entitlements to service in connection with the adoption of SFV.[205]

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[197] H.R. Rep. No. 29, *supra*, at p. 7.

[198] *Id.*

[199] S.R. Rep. No. 39, *supra*, at p. 2 and H.R. Rep. No. 29, *supra*, p. 2.

[200] See, *e.g.*, the discussion of gas versus coal competition in *Fuels Research Council, Inc.* v. *FPC*, 374 F.2d 842 (7th Cir. 1967).

[201] *E.g.*, Independent Petroleum Association of Mountain States, Colorado Oil and Gas Association, Independent Petroleum Association of New Mexico and Wyoming Independent Producers Association, Panhandle Eastern Pipeline Group (in most instances), and IPAA (presumption).

[202] *E.g.*, Natural Gas Supply Association/Indicated Producers and INGAA. The Department of Energy generally endorses the use of straight fixed variable but asks the Commission to "make it clear other rate designs will be approved on a case-by-case basis." Initial Comments at 3.

[203] *E.g.*, Distributors Advocating Regulatory Reform, Public Service Commission of the State of New York, Brooklyn Union Gas Company, Baltimore Gas and Electric Company, and Wisconsin Public Service Commission.

[204] Interstate Natural Gas Pipeline Rate Design, 47 FERC ¶ 61,295 at p. 62,054 (1989).

[205] *E.g.*, the Industrial Groups.

The Commission concludes that it is appropriate to allow reductions of contract entitlements to firm transportation service where another person is willing to take the capacity. The Commission has provided firm shippers with the ability to shed unwanted capacity to other persons desiring firm capacity via the capacity adjustment procedure of the restructuring proceedings discussed *infra*, and the capacity releasing mechanism, discussed, *supra*. The Commission concludes these mechanisms are adequate especially in light of the phasing-in of increases of 10 percent or greater in the revenue responsibility of an historic customer class as discussed above.

2. Pipeline Incentives

The Commission has stated in the past that pipelines need an incentive to keep their costs low through an exposure to risk through the assignment of fixed costs to the usage charge.[206] Under SFV, no fixed costs are assigned to the usage charge. Many commenters focused on this point.

The Commission intends to continue to ensure that construction projects are prudent and, of course, pipeline customers may challenge the prudence of pipeline expenditures in rate proceedings. In addition, with respect to transportation throughput, the pipelines will now have much less influence on the use of their systems because they are transporting gas to, rather than selling gas at, the city gate. Transportation volumes will mainly be a function of the needs of gas purchasers and the prices offered by gas sellers in the production areas. The Commission believes that incentive ratemaking may be a better vehicle than exposure to risk for enhancing pipeline efficiency with respect to transportation costs. The Commission is awaiting comments on the proposed policy statement on incentive ratemaking.[207] The proposed policy statement also specifically requested comments on how that policy proposal relates to the rate design methodology proposed in the NOPR. The Commission also recognized that there is a relationship between the proposed policy statement and any restructuring proceedings necessitated as a result of this final rule and stated that, after a review of the comments filed in Docket No. PL92-1-000, the Commission will issue guidance in that docket on how a final policy statement affects these restructuring proceedings. The Commission expects to consider the final policy statement in the near future to accomplish this objective in a timely manner.

Last, the Commission received many helpful comments on the impact of SFV on the analysis of pipeline risk in determining rate of return on equity.[208] However, the Commission will not address this issue here because pipeline risk is a matter for pipeline-specific analysis in light of all risks. SFV is but one aspect of risk analysis. This issue is more appropriately addressed in rate proceedings where the Commission examines all other factors affecting risk and establishes the pipeline's allowed rate of return on equity.

3. Gas Purchase Decisions

Niagara Mohawk Power Corporation argues that the Commission's competitive analysis is incorrect because gas purchasers choose between long-term gas suppliers by estimating the "*total* delivered cost of the gas (including both the supply cost and the transportation demand and commodity charges)".[209] Niagara Mohawk asserts that the gas purchasers will not change gas suppliers based on mere changes in the commodity component (gas cost and transportation commodity charge). The Commission recognizes that gas purchasers enter into long-term and short-term contracts based on the expected total delivered cost. However, even so, this does not invalidate the Commission's analysis. First, the active and viable spot market indicates that a significant amount of gas is purchased on a short-term as well as on a long-term basis.[210] Many purchasers are now developing portfolios of gas supply contracts that are both short- and long-term.[211] Those gas purchasers must make their decisions by comparing the expected incremental cost of the deals available. Spot market sales should continue to play a role in the gas sales market with the implementation of unbundled transportation because a significant amount of gas now moving on an interruptible basis to gas buyers should move on a firm basis, improving the quality and lowering uncertainty associated with gas transactions. This may even increase the use of spot gas to satisfy both base load and peak needs, since the marginal delivered cost to the buyer should be lower because of the combination of unbundled firm transportation and the use of SFV. Hence, the Commission's analysis is directly applicable to a significant and important segment (spot sales) of the natural gas market.

Second, gas purchasers will not be prevented from continuing an expected total cost analysis in entering into new long-term contracts. And it may be easier to compare potential gas sources because no fixed costs under SFV will vary by the estimated purchase volumes. Removing this uncertainty should promote more efficient gas contracting decisions.

IX. Pipeline Sales

A. Blanket Sales Certificates

The Commission is requiring all pipelines that provide open access transportation to offer their sales services on an unbundled basis. To this end, the Commission is issuing to pipelines holding a blanket transportation certificate under subpart G of part 284 of the Commission's regulations, or performing transportation under subpart B, a blanket certificate authorizing firm and interruptible sales for resale. All firm and interruptible sales services will be provided as unbundled services under the blanket sales certificate. This form of regulation will enable the pipelines to compete directly with other gas sellers on the same terms at prices determined in a competitive market. The unbundled sales services will be afforded pregranted abandonment (see *infra*).

In addition, existing firm sales entitlements of the pipeline's customers will be converted to unbundled firm transportation rights. The pipeline's existing bundled, city-gate service obligation will be supplanted as of the effective date of the tariff sheets to be filed to comply with this rule. The firm sales customers will have the right to reduce their unbundled firm sales entitlements in whole or in part effective on the effective date of the blanket sales certificate. This will enable the pipeline's firm sales customers to freely negotiate the quantity and price of supplies purchased from the pipeline or other gas suppliers, and thereby take advantage of potential opportunities for

[206] See, *e.g.*, Texas Eastern Transmission Corp., 37 FERC ¶ 61,260 at p. 61,700-01 (1986).

[207] Incentive Ratemaking for Interstate Natural Gas Pipelines, Oil Pipelines, and Electric Utilities, Notice of Proposed Policy Statement on Incentive Regulation, Docket No. PL92-1-000, issued March 13, 1992, 58 FERC 61,287 (1992). Comments are due on or before April 27, 1992.

[208] See, *e.g.*, Transcontinental Gas Pipe Line Corp., 56 FERC ¶ 61,037 at p. 61,136 (1991) (The Commission imposed a 25 basis point reduction in the approved rate of return on equity to reflect the possibility of lower risk.).

[209] Initial comments at 32 (emphasis is original).

[210] See n. 41, *supra*. This is further attested to by the fact that in 1990 pipeline sales gas amounted to 21 percent of pipeline carriage for market and that interruptible transportation amounted to 51 percent of carriage for market. INGAA November 1991 paper, *Supra*, Tables A-1 and A-6.

[211] See Initial Comments of the American Gas Association at Appendix A.

long-term sales contracts in the competitive market.

During the restructuring proceedings, the firm sales customers may elect whether to continue their contractual relationship with the pipeline under the new blanket sales certificate. In making this election the customer can negotiate with the pipeline for the price it will pay for the gas. If the pipeline's price is higher than the price the customer is willing to pay, the customer can elect not to contract with the pipeline and can purchase supplies from another gas seller and the pipeline's sales service obligation ceases. If a customer elects to continue its firm sales service in whole or in part from the pipeline, then the pipeline's service obligation correspondingly continues until the contract terminates, either at the end of its term or by mutual agreement. If the customer elects to terminate its existing sales entitlement in whole or in part, the pipeline's corresponding obligation to serve that customer ceases. If the pipeline and a customer enter into a new contractual arrangement during the restructuring proceeding, that contract will define their relationship under the new blanket sales certificate which becomes effective at the culmination of the restructuring period when the Commission accepts tariff sheets putting the pipeline in full compliance with this rule. Under the new blanket sales certificate, the pipeline's sales obligation will be coextensive with its contractual obligations. When its unbundled sales contract expires, the pipeline is authorized to abandon its sales service.

A transportation only pipeline will not be required to offer and sell gas under the blanket sales certificate. Of course, such a pipeline may elect to offer gas in the future under the blanket sales certificate by filing appropriate tariff sheets.

In addition, the Commission is including standards of conduct and reporting requirements as part of the regulations governing blanket sales certificates for pipeline sales (see *infra*). The tariff sheets implementing the blanket sales certificate must be filed under section 284.14 of the regulations when the pipeline makes its compliance filing in the restructuring proceeding. Therefore, the pipeline may not implement sales service under the new blanket sales certificate until the Commission accepts those tariff sheets. The Commission does not intend to accept those tariff sheets until the pipeline is in full compliance with this rule.

To conclude, the Commission believes that the blanket sales certificates will be in the present or future public convenience and necessity because they will permit pipelines to make unbundled sales in a competitive production area market in furtherance of Congress' aims in enacting the Decontrol Act.

B. Pricing

The Commission has concluded above that pipelines that continue to sell gas must offer firm sales services that are unbundled from their transportation services. Hence, pipelines will be offering sales services separated from distinct transportation services. These pipeline sales services will be competing directly with unregulated sales by other sellers.

The NOPR proposed that pipelines would be allowed to adopt a market-based sales pricing mechanism for their unbundled firm sales services.[212] The NOPR's proposal was based on the Commission's intention to conclude that any pipeline sale markets are sufficiently competitive to prevent all pipelines from exercising significant market power.[213] The Commission's conclusion was grounded on two points. First, the Commission proposed to establish comparable transportation service by amending part 284. Second, the Commission proposed to conclude that adequate divertible gas supplies exist in all pipeline sales markets.[214] The Commission is adopting a rule that will allow pipelines to adopt a market-based pricing mechanism upon full compliance with the final rule. Some commenters argued that there may be areas where market-based rates are inappropriate. A contesting party in a particular restructuring proceeding can seek to prove that the particular pipeline's sales market is not sufficiently competitive. If that showing can be made, the Commission will decide the appropriate regulatory method to use in lieu of that adopted by this rule.

The Commission's competition conclusion rests on two points. First, the Commission will not approve a restructuring plan for any pipeline unless the Commission concludes that the pipeline will provide transportation services for all gas supplies in compliance with the equality principle adopted and defined by this rule. Second, as discussed below, the Commission is concluding that adequate divertible gas supplies exist in all pipeline markets.

The Commission's conclusion of adequate divertible gas supplies is grounded on Congress' passage of the Decontrol Act. As the Commission has stated:

> That act reflects Congress's finding that the natural gas sales market is competitive * * *. The sale of pipeline gas which is * * * unbundled from any transportation service is now part of that same natural gas market which Congress deregulated, and [the pipeline] is * * * competing directly against the producers and marketers whose gas sales Congress deregulated.[215]

Congress, therefore, has determined that gas sales at the wellhead, or in the field, are sufficiently competitive to justify decontrol of all first sales of gas supplies.[216]

Congress did not decontrol or deregulate gas pipelines or gas pipeline sales that are not "first sales." [217] However, at the time Congress acted, what existed was the traditional or classic bundled sales environment for pipeline sales, and not the unbundled sales environment instituted by this rule. The Commission believes that the Congressional finding of a competitive wellhead or field market applies to all sellers in that market, and that it is reasonable to infer that Congress believed that the production area market for natural gas is competitive on a national level without regard to the

[212] A market-based pricing mechanism could include, among others, two-part gas inventory charges and as-billed recovery of producer demand charges.

[213] The Commission previously concluded that it has the legal authority to approve market-based, unbundled, sales rates upon such a finding. Transcontinental Gas Pipe Line Corp., 55 FERC ¶ 61,446 (1991), *order on reh'g*, 57 FERC ¶ 61,345 (1991); El Paso Natural Gas Co., 54 FERC ¶ 61,316 (1991), *order on reh'g*, 56 FERC ¶ 61,290 (1991); Transwestern Pipeline Co., 53 FERC ¶ 61,298, at pp. 62,114–15 (1990); Transcontinental Gas Pipe Line Corp., 46 FERC ¶ 61,199, at p. 61,753 (1989); Transwestern Pipeline Co., 43 FERC ¶ 61,240, at p. 61,650–52 (1988), *reh'g granted in part*, 44 FERC ¶ 61,164 (1988), *remanded on other grounds*, Transwestern Pipeline Co. v. FERC, 897 F.2d 570 (D.C. Cir. 1990), *cert. denied*, 111 S. Ct. 373 (1990). Such market-based rates are consistent with the Commission's obligation to determine just and reasonable rates under the NGA and are consistent with the Decontrol Act. *See* Transwestern Pipeline Co., 53 FERC ¶ 61,298 at pp. 62,114–15 (1990).

[214] The Commission has found that a pipeline's sales are made in a sufficiently competitive market when the pipeline provides comparable transportation service with respect to all gas supplies from whomever purchased and when adequate divertible gas supplies exist. *E.g.*, Transcontinental Gas Pipe Line Corp., 55 FERC ¶ 61,446 (1991), *order on reh'g*, 57 FERC ¶ 61,345 (1991); El Paso Natural Gas Co., 54 FERC ¶ 61,316 (1991), *order on reh'g*, 56 FERC ¶ 61,290 (1991).

[215] Transwestern Pipeline Co., 53 FERC ¶61,298 at p. 62,115 (1990).

[216] S. Rep. No. 39, *supra*, at p. 3 ("[P]artial wellhead decontrol under the NGPA has helped to create an environment in which competition, not public utility-type regulation, is the dominant force in determining prices and supplies in the natural gas sales markets[.]").

[217] See discussion of the Decontrol Act, *supra*.

status of a particular gas merchant as first seller or non-first seller.

In addition, the Commission now finds that, except as discussed below, the issue of whether sufficient divertible gas supplies exist should not be part of its analysis to determine whether a pipeline possesses market power over sales. Throughout the country, there is a significant amount of uncommitted supplies available at competitive prices. In many areas, uncommitted supplies exceed the largest amount of gas controlled by any pipeline connected to the areas. Indeed, the Commission's experience in approving gas inventory charges in the past few years demonstrates that uncommitted gas supplies are avilable throughout North America.[218] This means that (with the existence of firm transportation under this rule) sellers of uncommitted supplies could replace pipeline sales, and that it will not be profitable for a pipeline to attempt to exercise market power over the sale of natural gas.

The Commission concludes that, after unbundling, sellers of short-term or long-term firm gas suppies (whether they be pipelines or other sellers) will not have market power over the sale of natural gas. To repeat, there is no doubt, as Congress expressly found and confirmed, that a competitive market exists for gas at the wellhead and in the field.

The Commission is, of course, aware of the possibility noted by several commenters [219] that particular markets may not be sufficiently competitive to support a finding that a particular pipeline lacks significant market power. Therefore, the Commission will permit any party in the restructuring proceeding to prove that adequate divertible supplies do not exist with respect to a particular pipeline. The Commission will consider these arguments in each restructuring proceeding and will examine any contesting party's claim that adequate divertible supplies do not exist. In addition, any party may raise the issue of adequate divertible supplies in proceedings subsequent to the restructuring proceedings.[220]

It is important to note that only Congress can "deregulate." Therefore, the Commission is instituting light-handed regulation, relying upon market forces at the wellhead or in the field to constrain unbundled pipeline sale for resale gas prices within the NGA's "just and reasonable" standard. The Commission will be regulating the pipeline sales in the same manner as it has done for sales for resale by marketers. Moreover, the Commission's conclusion is premised on the implementation in the restructuring proceeding of equally good quality firm transportation service for all gas supplies regardless of the seller's identity. Last, the Commission concludes that market-based pricing for unbundled pipeline sales is necessary to permit pipelines to compete for gas sales with their competitors on an equal basis with respect to pricing gas as a commodity, as well as in the transportation of gas on even terms and conditions. However, the Commission reiterates, the pipeline's authority to make market-based sales under the blanket sales certificates granted here will not be effective until the Commission accepts its filing in full compliance with the final restructuring rule.

The Commission rejects commenters' [221] argument that the Commission's light-handed regulation of unbundled pipeline sales does not conform to *Farmers Union Central Exchange, Inc.* v. *FERC.*[222] In that case, the court determined that a lightened regulatory hand is permissible so long as the regulatory scheme acts as a monitor to see if rates are within the "zone of reasonableness." [223] In this order, the Commission has determined that pipeline prices will be limited by a just and reasonable ceiling which is set by a competitive national gas market.[224] In addition, equal transportation must be provided on all pipelines. Hence, pipelines will have no significant market power as sellers. However, in the event parties prove that adequate divertible supplies do not exist with respect to a particular pipeline, the Commission will engage in more active regulation of that pipeline's sales. The Commission believes that the regulatory scheme under this rule will act as a monitor to ensure that rates are within a "zone of reasonableness."

C. Blanket Interruptible Sales Service

The NOPR proposed that there be no restrictions on pipeline unbundled interruptible sales services under the proposed blanket sales certificate. The rule adopted here requires the pipeline to offer firm and interruptible sales service only on an unbundled basis. In addition, the Commission has concluded that unbundled pipelines do not possess significant market power over sales. In that context, the Commission concludes that there should be no limitations or restrictions on pipeline unbundled interruptible sales services (other than standards of conduct, *see infra.*) The unbundling of pipeline sales services will enable producers, marketers, and pipelines to compete for long-term sales on the same unbundled basis. The Commission finds no reason why pipelines should be prohibited from competing on an even basis with producers or marketers for unbundled interruptible sales which are, in effect, short-term (spot) sales.

As with firm sales, the Commission will permit blanket interruptible sales only on an unbundled basis. As stated above, the interruptible sale of gas on an unbundled basis is necessary as a "barrier to undue discrimination in the offer of sale discounts." [225] This moots the interruptible sales service issues considered during the May 2, 1990 Technical Conference in *Arkla Energy Resources, Inc., et al.*[226] Any blanket certificates for interruptible sales on a bundled or unbundled basis will be merged into or subsumed within the pipelines' blanket sales certificates.

D. Standards of Conduct

Order No. 497 [227] adopted standards of conduct and reporting requirements

[218] *See, e.g.*, Transcontinental Gas Pipe Line Corp., 55 FERC ¶ 61,446 (1991), *order on reh'g*, 57 FERC ¶ 61,345 (1991), and El Paso Natural Gas Co., 54 FERC ¶ 61,316 (1991), *order on reh'g* 56 FERC ¶ 61,290 (1991).

[219] *E.g.*, New England Distributors, Marathon Oil Company, and Associated Natural Gas Company.

[220] El Paso Natural Gas Co., 56 FERC ¶ 61,290 at p. 62,174 (1991) ("[P]arties may file a complaint with the Commission to present evidence of any change in market conditions which may give market power to El Paso.").

[221] *E.g.* Gas Company of New Mexico and Northern Illinois Gas Company, Peoples Gas Light & Coke Company and North Shore Gas Company.

[222] 734 F.2d 1486 (D.C. Cir. 1984), *cert. denied*, 469 U.S. 1034 (1984).

[223] See El Paso Natural Gas Co. 56 FERC ¶ 61,290 at p. 62,174 (1991).

[224] See also Importance of Market Centers, *supra*, at pp. 11–14 (The staff concluded that each of seven production-area market centers has significant uncommitted supplies and that most, if not all, of those supplies would be expected to be economically divertible to customers of interstate pipelines.).

[225] El Paso Natural Gas Co., 50 FERC ¶ 61,363 at p. 62,094 (1990). See also Arkla Energy Resources, Inc., 50 FERC ¶ 61,366 at p. 62,103 (1990) ("In *El Paso*, * * * the Commission precludes pipeline ISS merchant service from having an undue advantage over pipeline transportation service by means of the movement of the point at which title to ISS gas transfers [to mainline receipt points].").

[226] 50 FERC ¶ 61,366 (1990). This proceeding will be terminated.

[227] Inquiry Into Alleged Anticompetitive Practices Related to Marketing Affiliates of Interstate Pipelines, Order No. 497, 53 FR 22139 (June 14, 1988), FERC Stats. and Regs. [Regulations Preambles 1986–1990] ¶ 30,820 (1988), *order on reh'g*, Order No. 497–A, 54 FR 52781 (Dec. 22, 1989), FERC Stats. and Regs. [Regulations Preambles 1986–1990] ¶ 30,868 (1989), *order extending sunset date*, Order No. 497–

Continued

for interstate pipelines with marketing affiliates.[228] In brief, the pipeline is prohibited from preferring its marketing affiliate over unaffiliated shippers with respect to transportation matters, access to information, and transportation discounts.[229] In addition, pipelines are required to establish and file with the Commission procedures to enable shippers and the Commission to determine how the pipeline is complying with the standards of conduct.

The NOPR proposed to continue Order No. 497's standards of conduct and reporting requirements for interstate pipelines with marketing affiliates and to apply those standards and requirements to the pipeline when it provides unbundled sales services.

The Commission is continuing Order No. 497's standards of conduct and reporting requirements for interstate pipelines with marketing affiliates even though the pipelines will be making sales on an unbundled basis with transportation separately provided.[230] This is because there is no change in the competitive relationship between marketing affiliates and other shippers, and the need to protect nonaffiliated customers from preferences that could be given to affiliated shippers.

The Commission also concludes that Order No. 497's standards of conduct and reporting requirements should apply to the pipeline when it provides unbundled gas sales services. The pipeline as a merchant would be the functional equivalent of a marketing affiliate. Therefore, nonpipeline suppliers and other customers need appropriate protection from undue preferences that could be given to the pipeline as merchant just as much as protection is needed from potential preferences that could be given to marketing affiliates. Accordingly, the Commission will include standards of conduct and reporting requirements as part of the regulations with respect to blanket sales certificates for unbundled pipeline sales.

Pipelines offering unbundled blanket sales services will be required to organize their sales and transportation operating employees so that they function to comply with §§ 161.3(a), (b), (d), and (1) and to comply with (c), (e), (f), (g), (h), and (i) by considering their sales operating employees as an operational unit which is the functional equivalent of a marketing affiliate. In addition, those pipelines will be required to conduct their business in conformity with the equality requirements of §§ 284.8(b)(2) and 284.9(b)(2) by not giving shippers of gas sold by the pipeline any preference over shippers of gas sold by any other merchant in matters relating to part 284 transportation. Consistent with General Instruction No. 2 of the Uniform System of Accounts,[231] pipelines must maintain sufficient accounting records to ensure that the cost of providing each unbundled service can be identified and assigned to such service. For any costs in which direct assignment is not possible or practicable, for example general overhead costs, the pipeline may use any reasonable method for allocating such costs among the various services. However, pipelines must clearly identify each type of indirect cost, and provide justification of the indirect cost allocation methods selected.

Moreover, the pipelines would be required to file procedures [232] and to comply with § 250.16 by considering their sales operating employees as an operational unit that is the functional equivalent of a marketing affiliate.[233] However, the reporting requirement should not require pipelines to file separate Form 592 reports with the Commission. Where pipelines already file marketing affiliate reports with the Commission they should file just one combined report for transactions involving marketing affiliates and unbundled pipeline sales.[234]

Many pipelines [235] and some other commenters [236] oppose the Commission's application of standards of conduct and reporting requirements to unbundled pipelines. They argue that the requirements are unnecessary because the market will regulate competition and the NGA prohibits undue discrimination, that their competitors are not subject to such requirements so pipelines will be at a competitive disadvantage, and that the requirements will be too burdensome.

The Commission concludes that the standards of conduct and reporting requirements are necessary to ensure that the pipeline does not favor itself as a merchant over the gas suppliers in performing its trasportation function. The pipelines are not similar to other merchants because the pipelines control the transportation network. This is a sufficient difference to necessitate the requirements adopted here.

Some commenters [237] argued that the requirements should be strengthened. The Commission believes that any change in the requirements should be considered for both pipeline sales and pipeline marketing affiliate sales at the same time. Hence, the commenters' proposals to strengthen the requirements will not be considered here.

Last, the Commission rejects commenters' [238] requests that small pipelines be exempted on a generic basis from the standard of conduct and reporting requirements. Small pipelines have the same potential for favoring their own sales as do larger pipelines. The Commission will, however, as it has in the past, consider individual requests for waiver from the requirements where it finds that the potential for preferences has been otherwise mitigated.[239]

E. Reporting Requirements

The Commission is requiring the pipelines to file annual reports with respect to their sales under the blanket sales certificate. Currently, Section 154.1(a) provides that pipelines are not subject to the "reporting requirements of [P]art 154 governing the filing of contracts, service agreements and related information * * * [for] the sale or transportation of natural gas pursuant to [P]art 284." The Commission is making no change in this regulation.[240] However, the Commission is waiving the requirements of Part 154 of its regulations with respect to the filing of the sales prices between the pipeline and each of its sales customers. The

B, 55 FR 53291 (Dec. 28, 1990), FERC Stats. and Regs. [Regulations Preambles 1986–1990] ¶ 30,908 (1990), *order extending sunset date and amending final rule*, Order No. 497–C, 57 FR 9 (Jan. 2, 1991), III FERC Stats. and Regs. 30, 934 (1991), *reh'g denied*, 57 FR 5815 (Feb. 8, 1992), 58 FERC ¶ 61,139 (1992).

[228] 18 CFR Parts 161 and 250. See also Algonquin Gas Transmission Co., *et al.*, 55 FERC ¶ 61,261 (1991) with respect to pipeline compliance with the reporting requirements of § 250.16 of the Commission's regulations.

[229] 18 CFR 161.3.

[230] Order No. 497–C, 57 FR 9 (Jan. 2, 1992), III FERC Stats. and Regs. 30,934 (1991), *reh'g denied*, 57 FR 5815 (Feb. 18, 1992), 58 FERC ¶ 61,139 (1992).

[231] 18 CFR Part 201, General Instruction No. 2.

[232] This requirement would be similar to that of 18 CFR 161.3(j).

[233] Section 250.16 sets forth reporting requirements.

[234] The Commission's Form No. 592 is being modified to accommodate this minor change.

[235] *E.g.*, Coastal Companies, Panhandle Eastern Pipeline Group, Tenneco Gas, and Southern Natural Gas Company.

[236] *E.g.*, Affiliated Natural Gas Marketers Association, American Gas Association, and Equitable Resources Energy Group.

[237] *E.g.*, Producer-Marketer Transportation Group, Appalachian Energy Group, Independent Petroleum Association of Mountain States, and Hadson Gas Systems.

[238] *E.g.*, Pacific Interstate Offshore Company and Pacific Offshore Pipeline Company.

[239] Northern Border Pipeline Co., *et al.*, 55 FERC ¶ 61,262 (1991).

[240] 18 CFR 154.1(a). Final Regulations Clarifying the Filing Obligations for part 284 Transportation and Sale of Natural Gas, Order No. 516, 54 FR 47758 (Nov. 17, 1989), FERC Stats. & Regs. [Regulations Preambles 1986–1990] ¶ 30,864 (1989).

Commission believes that the reporting requirement added by this rule satisfies the filing requirements of the NGA when the purchaser is on notice of the rate and the amount of total revenues from each purchaser is eventually filed with the Commission as an average price as required by the reporting requirement.[241] In addition, the Commission believes that this is appropriate here because the pipeline sales rates will be negotiated with the purchasers. This eliminates the need for advance notice of the pipeline's prices because market-based pricing abviates concerns about discrimination among gas purchasers. In addition, this will enable the pipelines to compete on an even basis with their competitors for gas purchasers because those competitors are under no obligation to disclose their prices to the pipeline.[242]

X. Pipeline Service Obligations (After Restructuring Proceedings)

A. Introduction

In *American Gas Association v. FERC* (*AGA II*),[243] the United States Court of Appeals for the D.C. Circuit reviewed the Commission's regulations promulgated in Order Nos. 500–H and 500–I, and remanded to the Commission the portion of the Commission's decision which provided for pregranted abandonment for each transportation arrangement authorized under a blanket certificate, including transportation arrangements arising out of a sales customer's exercising its right to convert a purchase arrangement to transportation. The court held that the Commission has authority in appropriate circumstances to permit pregranted abandonment under blanket certificates.[244] The court recognized that the event that triggers the pregranted abandonment may be contract expiration. However, the court directed the Commission to develop a further explanation of the criteria under which pregranted abandonment would be permitted. The court was unpersuaded by the Commission's argument that pregranted abandonment helps ensure that capacity will not be retained by existing customers if it is not needed by them, noting that the primary determinant of whether a customer will hold onto excess capacity rights is the size of the demand charge and the degree to which it is related to peak-period use.[245] The court stated that the Commission had not adequately explained how pregranted abandonment trumps another basic precept of natural gas regulation—protection of gas customers from exercise of monopoly power through refusal of service at the end of the contract.[246]

On remand of *AGA II*, in Order No. 500–J the Commission stayed the operation of the pregranted abandonment regulation at issue there, 18 CFR 284.221(d). The stay applied where a customer converted firm sales service to firm transportation service after February 13, 1991, and the Commission indicated its intention to address the issue of pregranted abandonment of transportation service in the context of the instant rulemaking.[247]

Requests for rehearing of Order No. 500–J were filed by numerous parties.[248] Generally, on rehearing, the local distribution companies and state commissions argued that the Commission should vacate its pregranted abandonment rule *in toto*, for firm contracts that are one year or more in length, or should extend the stay to small customers who have already converted from firm sales to firm transportation services. The pipelines mainly argued that the stay should be rescinded or at least be only temporary.

After the decision in *AGA II*, the Supreme Court analyzed the Commission's authority to pregrant abandonment in *Mobil Exploration and Producing Southeast, Inc.* v. *United Distribution Companies* (*Mobil*).[249] The Court held that the Commission has authority under Section 7(b) of the Natural Gas Act (NGA) to decide the issue of abandonment of service in advance, even before service has begun, and that the Commission may make such a determination generically, covering an entire class of cases.[250] As the Court explained, section 7(b) does not compel the Commission to make specific findings with regard to every abandonment where the issues involved are general. For the reasons discussed fully below, the Commission finds that the proposal in the final rule is consistent with the requirements of section 7(b) as interpreted in these decisions.

B. Overview of Final Rule

As part of the effort to foster competition in the natural gas industry, the Commission, in the final rule, is allowing the industry greater flexibility to control transactions through negotiated contracts. Consistent with these steps, it is the Commission's view that a pipeline's service obligation also should be determined, in the first instance, by the contract negotiated by the parties. Thus, the regulations to apply after the initial restructuring required by this rule is complete,[251] generally pregrant abandonment of pipeline service obligations upon the termination of the service contracts, with one exception. During the restructuring proceedings, a pipeline is permitted automatic abandonment of the obligation to transport for a firm shipper, if the firm shipper relinquishes its rights to capacity to a competing bidder rather than agreeing to pay a rate, up to the maximum rate, to match the competing bidder's offer. This one-time only abandonment provision during restructuring proceedings is described fully in section XI.A, *infra*.

In § 284.221(d), which applies after the restructuring period, the final rule authorizes pregranted abandonment of interruptible and short-term firm transportation at the expiration of the contract. The rule defines short-term transportation as transportation under a contract with a term of one year or less. In § 284.285, the rule also authorizes pregranted abandonment for unbundled firm and interruptible gas sales service at the expiration of the contract. Thus, under the rule, a pipeline may cease

[241] *City of Piqua* v. *FERC*, 610 F.2d 950 (D.C. Cir. 1979).

[242] See Transcontinental Gas Pipe Line Co., 55 FERC ¶ 61.446 at p. 62.355–6 (1991).

[243] 912 F.2d 1496 (D.C. Cir. 1990), *cert. denied*, 111 S. Ct. 957 (1991) (AGA II).

[244] See also, Associated Gas Distributors v. FERC, 824 F.2d 981, 1015 n.17 (D.C. Cir. 1987) (AGD I), *cert. denied*, 485 U.S. 1006 (1988).

[245] AGA II, *supra*, 912 F.2d 1496 at 1517.

[246] *Id.*

[247] Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, Order No. 500–J, 56 FR 6962 (Feb. 21, 1991); III FERC Stats. & Regs. § 30.915 (1991).

[248] Natural Gas Pipeline Company of America, Tennessee Gas Pipeline Company, Panhandle Eastern Pipe Line Company and Trunkline Gas Company, Texas Eastern Transmission Corporation, jointly by Northern Natural Gas Company, Florida Gas Transmission Company, and Transwestern Pipeline Company (Enron), the City of Willcox, Arizona and Arizona Electric Power Cooperative, the State of Michigan and the Michigan Public Service Commission, Indicated Parties, United Distribution Companies (UDC), Associated Gas Distributors, National Association of Gas Consumers, Pacific Gas and Electric Company and the Public Utilities Commission of the State of California.

[249] 111 S. Ct. 615 (1991).

[250] Section 7(b) states: No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment.

[251] Regulations governing the procedures to determine the pipeline service obligation during restructuring are discussed in section XI.A., *infra*.

providing service at the expiration of the contract for these services without first obtaining individual abandonment authority from the Commission under section 7 of the NGA. Similarly, for long-term transportation, the rule permits the parties to determine the pipeline's service obligation through contractual provisions such as roll-over or evergreen clauses. This will be discussed more fully below. Because the definition of transportation is being changed by this rule to include storage, the pregranted abandonment provisions will also apply to storage. However, pregranted abandonment will not apply to existing contract storage because existing contract storage was not authorized under part 284.

The Commission finds that pregranted abandonment is appropriate for short-term and interruptible transportation because the nature of these services is such that the customers selecting those service options do not rely on continued service at the expiration of the contract. Pregranted abandonment for unbundled sales is appropriate because, as discussed more fully below, a pipeline service obligation is no longer necessary to ensure access to gas supply.

The Commission recognizes that long-term firm transportation (over one year) has characteristics different from the services described above, and, accordingly, the final rule places limitations on pregranted abandonment of long-term firm transportation service. These limitations balance the benefits of greater competition with the shippers' need for continuity of service. First, for long-term firm transportation services, a pipeline and its customers may by contract continue the pipeline's service obligations by extending the term of the contract through inclusion of roll-over or evergreen provisions so that customers have the option to renew or extend the contracts.[252]

Even if a contract does not contain an evergreen or roll-over clause, a pipeline may not abandon service to a long-term firm transportation shipper if that customer elects, within a reasonable time, to exercise a right of first refusal by agreeing to match the terms (as to price and length) of another offer to purchase service from the pipeline. Only if the shipper is unwilling to pay up to the maximum rate, and match the duration of the contract of another offer, will the pipeline's service obligation be abandoned at the expiration of the contract. The details of how the right must be exercised must be worked out in the individual restructuring proceedings and specified in the pipelines' tariffs.

This order and the final regulations resolve the issues that were raised in the requests for rehearing of Order No. 500–J, and the requests for rehearing are granted and denied, consistent with this order. This order explains, *infra*, that pregranted abandonment will not apply to conversions that took place during the period that the Order No. 500–J stay was in effect, *i.e.*, from February 13, 1991, to the effective date of the regulations promulgated in this order.

The specifics of the final rule with respect to each type of service, the comments received on the proposed rule, and any changes from the proposed rule are discussed in greater detail below.

C. Interruptible Transportation and Short-Term Firm Transportation Service

Section 284.221(d), as amended by the final rule, incorporates the proposal in the NOPR and authorizes pregranted abandonment for all interruptible and short-term (less than one year) firm transportation. The nature of these services is such that customers selecting these options do not rely on continued service at the expiration of the contract. Interruptible customers choose to pay lower rates for less secure service. Short-term transportation customers choose the flexibility of short-term service rather than the stability of long-term commitments. In *AGA II*, the court noted that there was no claim that pregranted abandonment was inappropriate for interruptible transportation. Thus, there were virtually no challenges to the legal basis for authorizing pregranted abandonment for these services.

D. Unbundled Sales Service

The final rule in section 284.285 authorizes pregranted abandonment for unbundled firm and interruptible pipeline sales. Pipelines may cease service to customers for firm and interruptible unbundled gas sales upon termination of their contract without any further action by the Commission. Thus, with the blanket sales certificate, and pregranted abandonment of the sales obligation at the expiration of the sales contract, pipelines are placed in a position that is more comparable to unregulated sellers with which the pipelines must compete. The new post restructuring service obligation of a pipeline to sell gas on a unbundled basis will be co-extensive with its contractual obligation.

While most commenters, including the LDCs, do not object to pregranted abandonment of unbundled sales services, several have challenged the legal basis for this proposal. Laclede Gas Company (Laclede) and several other commenters [253] argue that pregranted abondonment of unbundled sales service violates Section 7(b) of the NGA. The commenters generally recognize that the Commission can authorize abandonmenmt of services on a generic basis, but argue that that authority is circumscribed by the specific requirements of section 7(b). Laclede argues that section 7(b) requires, among other things, that the Commission find on the basis of substantial evidence in the record that the present or future public convenience and necessity allows the abandonment. Midwest Energy opposes the proposal unless the pipeline is required to demonstrate that comparable access to essential transportation, production, and storage exists, and that a workably competitive market for firm gas supply has developed in the relevant geographic market. Similarly, Consolidated Edison argues that in order for the Commission to authorize pregranted abandonment of unbundled sales service, it must first find that sufficient divertible gas supplies currently exist; Consolidated Edison maintains that such a finding is premature.

The Commission disagrees with these arguments. The Commission is authorized to pregrant abandonment upon contract expiration or termination upon a finding that the abandonment is permitted by the present or future public convenience or necessity, pursuant to section 7(b) of the NGA.[254] The Commission here finds that pregranted abandonment of firm and interruptible unbundled gas sales service upon termination or expiration of the sales contract is permitted by the present or future public convenience and necessity because a continuing pipeline service obligation is no longer necessary to ensure LDCs access to gas supply. Moreover, pregranted abandonment will further the goal of placing all natural gas sellers on an even basis.

The Commission has found above that sufficient divertible gas supplies exist nationwide to prevent a pipeline from exercising market power over the supply of gas at the termination of a

[252] "Roll-over" and "evergreen" clauses permit the customer at its option to extend the term of the contract. For long-term firm transportation contracts, the pipeline must offer these provisions on a non-discriminatory basis.

[253] *E.g.*, comments of Midwest Gas and Consolidated Edison Company of New York, Inc.

[254] AGA II, *supra*; Mobil, *supra*. See discussion, *supra*.

contract.[255] Thus, individual abandonment proceedings are not needed to protect LDCs from market power over natural gas supplies and assure continued access to supply. With unbundled firm transportation, LDCs will have as many gas supply options as the pipelines. In addition, the final rule requires pipelines that currently make firm city-gate sales to offer a "no-notice" transportation service [256] that, in combination with unbundled sales, can provide reliable deliveries of gas up to the customer's contract demand level during periods of peak demand. Each firm customer will be entitled to continue this transportation service beyond the term of existing long-term contracts, and preclude the pipeline from abandoning such service, by exercising contractual roll-over or evergreen provisions or by exercising a right of first refusal, as described more fully below. Thus, LDCs will be able to secure new supplies of gas in a competitive market, either from the pipeline or other sellers, without being subject to pipeline market power over such supply, and will be assured of the means of transporting that gas when it is needed.

Moreover, the rule does not limit the current ability of pipelines and their sales customers to negotiate unbundled sales contracts containing "roll-over" and "evergreen" clauses, such that customers have the option of renewing or extending gas supply commitments from the pipeline. Thus, the application of the pregranted abandonment for unbundled sales service would be deferred as to contracts containing such clauses as long as the purchaser continues to renew or extend the contract because the contractual relationship has not terminated.[257] The inclusion of such clauses in agreements for unbundled sales is a matter of contract, to be determined by the negotiations of the parties, and not by Commission rule or policy.

In addition, pregranted abandonment of future unbundled sales service will further the goals of this rule by permitting pipelines to provide sales service on a more competitive basis with other gas suppliers, who have already been relieved of service obligations that extend beyond the terms of their gas supply contracts by virtue of the NGPA, the Decontrol Act, and previously established Commission policies. In 1978, section 601(a)(1)(A) of the NGPA removed the Commission's NGA jurisdiction over first sales of new gas that was not dedicated to interstate commerce before the NGPA's enactment, and thus obviated the necessity for producers to secure certificates of public convenience and necessity to sell such gas for resale in interstate commerce, or to secure abandonment authority to discontinue such sales. Subsequent Commission regulations promulgated under Order No. 451 (Ceiling Prices: Old Gas Pricing Structure) and Order No. 490 (Abandonment of Sales and Purchases under Expired, Terminated, or Modified Contracts) provide producers with blanket sales certificates with pregranted abandonment for pre-NGPA gas. Marketers have been granted blanket sales certificates with pregranted abandonment.[258] As of January 1, 1993, all first sales of gas will be removed from the Commission's NGA jurisdiction under the Decontrol Act. With the unbundling of transportation required by this rule, it is now appropriate to allow pipelines to compete with these other sellers on an analogous basis.

E. Long-Term Firm Transportation

Once again, the following discussion pertains to the application of the regulations after the initial restructuring proceedings are completed. Section 284.221(d), as amended by this rule, places limits on pregranted abandonment of long-term firm transportation service.[259] The criteria established for pregranted abandonment for long-term transportation contracts of long-term firm transportation will foster competition and economic efficiency, and streamline the administrative process, while protecting the legitimate needs of many customers for continued service. The parties may choose to defer application of pregranted abandonment by including evergreen or roll-over clauses in their service contracts. Thus, in the first instance, the parties will decide whether their service obligations under the contract will be subject to pregranted abandonment. If these provisions are not included in the contract, the customer is still assured the right to continued service if it meets competitive bids, as discussed below.

Under the rule, the parties' ability to use an evergreen or roll-over clause to guarantee the firm shipper a continuing discounted rate will depend on the terms of the existing contract. For example, if the existing contract guarantees the shipper the right to extend the term of the contract at a rate that is less than the maximum rate, the terms of the contract will govern. Otherwise, if there is unsatisfied demand for the capacity, the firm shipper must be prepared to pay up to the maximum rate to retain the capacity. If however, the pipeline has unused capacity, the parties can negotiate a discounted rate.

These limitations on the pregrant of abandonment for long-term transportation reflect the Commission's determination that the current regulation, which provides for unconditional pregranted abandonment,[260] is not appropriate for firm transportation with a duration of more than one year. The key to continuity of service for a customer is the right to transportation capacity, regardless of the source of gas. The final rule provides customers with the ability to ensure the continued availability of transportation capacity. The Commission finds that with these limitations on pregranted abandonment for long-term firm transportation, the rule meets the requirements of the court in *AGA II*.

1. Comments on the NOPR

Several commenters have challenged pregranted abandonment of long-term firm transportation service, alleging that the process is inconsistent with section 7(b) of the NGA. Atlanta and Chattanooga argue that permitting abandonment on a generic basis, subject only to an existing customer's right of first refusal is incompatible with section 7(b) of the NGA as that section has been interpreted by the courts in *Michigan Consolidated Gas Co.* v. *FPC*[261] and *Transcontinental Gas Pipe Line Corp.* v. *FPC*.[262] Atlanta and Chattanooga argue that, consistent with these decisions, abandonment may be authorized only after hearing and a finding that the abandonment is permitted by the public convenience and necessity.

However, neither of the cited cases involves the issue of pregranted abandonment and cannot, in light of *AGA II* and *Mobil*, be read to require

[255] Any allegation that this conclusion does not apply to a particular pipeline will be addressed on a case-by-case basis in the restructuring proceedings. See discussion, *supra*.

[256] Described *supra* at section VII.D.

[257] Existing contracts with evergreen clauses will also preclude the availability of pregranted abandonment as long as the customer elects to continue receiving sales service under the contract.

[258] *E.g.*, TXG Gas Marketing Co., 55 FERC ¶ 61,063 (1991).

[259] There are different procedures that apply during the restructuring proceedings that are discussed *infra* at section XI.A.

[260] 18 CFR 284.221(d). See discussion, *supra*.

[261] 283 F. 2d 204 (D.C. Cir. 1960), *cert. denied*, 364 U.S. 913 (1960)

[262] 488 F. 2d 1325 (D.C. Cir. 1973), *cert. denied*, 417 U.S. 921 (1974).

the Commission to make an individual determination in all abandonment proceedings. To the extent those cases require a comparative analysis of the public interest considerations for the existing service and the new service, that analysis is set forth in this order, *supra*, and is the basis for the Commission's authorization of pregranted abandonment.

Associated Gas Distributors (AGD) and Consolidated Edison state that a regulation establishing criteria necessary for continuation of service would not be inconsistent with section 7(b), but a regulation that provides a new customer with an opportunity to take capacity away from an existing customer because it offers different terms would undercut the purpose of the statute. The distinction between the Commission's proposed right of first refusal and a "right to continue" service, as proposed by AGD, is semantic, not substantive. In any event, evergreen and roll-over clauses will provide this right to continue service.

2. The Right of First Refusal

a. *Rate requirement.* The exercise of the right of first refusal established in the final rule, that will apply after the restructuring proceedings are complete, will be a means of avoiding pregranted abandonment, in the absence of contractual provisions to extend the contract duration. This right of first refusal will enable any long-term firm transportation customer, including formerly bundled city-gate sales customers, to continue receiving that firm service by agreeing to pay up to the maximum rate and matching the length of contract term offered by another customer who wants and values the service. If the pipeline is willing to discount the transportation rate for competitive reasons, the pre-existing customer may retain the capacity by matching the highest rate, up to the maximum, offered by a competing bidder.[263]

Consolidated Edison of New York and Kansas Power & Light asked for clarification on matching competing bids from a downstream customer. The maximum rate that must be matched means the highest rate the pipeline is authorized to charge for the capacity sought. A bidder in a downstream zone may not force an existing customer in an upstream zone to match the higher maximum rate for capacity to the downstream bidder's delivery point. The maximum rate an existing capacity holder must match is the maximum rate the pipeline can charge for delivery to the existing customer's delivery point. The downstream bidder, however, must bid up to the maximum rate for delivery to its delivery point. If each shipper bids the maximum rate for its zone, and the same length for contract duration, then the existing capacity holder retains its capacity.

This procedure allows the rate to play a role in rationing capacity, but caps the rate at a just and reasonable level. The maximum rate contained in the applicable tariff and approved by the Commission will be at a just and reasonable level and not at a level that results in monopoly rents to the pipeline. The pipeline cannot under any circumstances collect a rate that is above a just and reasonable level, but competitive circumstances may result in a lower rate.

The rate regulations for open access transportation require that pipelines establish a maximum rate designed to recover all of the costs (and only such costs) properly allocated to the service to which the rate applies, and a minimum rate based on the average variable costs.[264] The existing customer is entitled to continue long-term transportation service by matching whatever transportation rate (within the maximum and minimum rates) is offered by another party. If there are no competing offers, the existing customer and pipeline establish the rate (within the maximum and minimum) by negotiation. Therefore, an existing holder of capacity is entitled to continue to receive transportation service upon expiration of its long-term contract, but not necessarily at a discount.

b. *Contract term.* The second requirement of the right of first refusal upon expiration of a long-term contract is that the existing transportation customer agree to match the longest contract term offered by another customer interested in receiving the service. Thus, if a competing bidder offers to pay the maximum transportation rate for a term of 20 years, the existing customer cannot retain the capacity by agreeing to pay the maximum rate for some shorter term. But if there are no competing offers, the existing customer is entitled to continue the transportation service for whatever term it chooses.[265] Therefore, an existing holder of capacity is entitled to continue to receive transportation service upon expiration of a long-term contract, but not necessarily on a short-term basis, unless there are no other customers bidding on the capacity.

Several LDCs and state agencies argue that the right of first refusal should apply to the price term only, *i.e.*, that the bidder should be required only to bid the highest Commission approved rate.[266] These parties argue that while it may be appropriate to make the LDC pay the highest cost-based rate, it would not be appropriate to require them to match the term for contract duration. Otherwise, these parties assert, bidding wars will result in excessively long contracts, tying up capacity, contrary to the goals of the rule.[267] Furthermore, several parties argue that LDCs cannot reasonably be expected to know their requirements beyond 10 years.

Others argue that the maximum term required to be matched should be limited to a specific period, which, when elected, would automatically entitle the existing customer to continued service. Distributors Advocating Regulatory Reform (DARR) suggests a term of three years; Central Illinois Public Service Company suggests a term of ten years; and Consolidated Edison suggests a minimum term of five years.

The Commission will require existing customers to match the length of competing bids for capacity under expired contracts, as well as price, in order to retain the capacity. This proposal strikes the appropriate balance between the needs of customers for continued service and the benefits of competition in establishing the terms of service. In the first instance, the parties have control over the timing of pregranted abandonment as to their contracts and can defer the abandonment of the pipeline's service obligation by including a roll-over or evergreen clause.[268] Absent such a contractual provision, other shippers desiring the service may compete for it. Existing customers may have the greatest need for continuation of firm transportation under their expiring

[263] There is also a similar provision that applies during the restructuring proceeding that is discussed, *infra*, at section XI.A. During the restructuring proceedings, the holder of firm capacity has an opportunity to shed unneeded capacity prior to expiration of its contract, if there is a demand for its capacity, thus triggering the automatic abandonment provisions of § 284.14.

[264] 18 CFR 284.7(d) (4) and (5).

[265] Although if the extended term is one year or less, it will be subject to the pregranted abandonment authorized for short-term transportation contracts upon expiration of the contract.

[266] *E.g.*, Niagara Mohawk Power Corp., Baltimore Gas and Electric Co., Cascade Natural Gas Corp., Long Island Lighting Co., and Minnesota Dept. of Public Service.

[267] *E.g.*, comments of Distributors Advocating Regulatory Reform.

[268] Pipelines are not required to include rollover or evergreen clauses in transportation contracts, but if they do so, these clauses must be offered on a nondiscriminatory basis for all shippers, consistent with existing Commission policy.

contracts, and continuation of that service to them may be the most efficient use of the capacity. The rule assures them this opportunity. But there must also be an opportunity for other shippers desiring the capacity to submit competing bids, which the existing customer can then match or not. This process affords an efficient, market-sensitive means of comparing the needs of the existing customer to those of competitors for the capacity, and measuring whether or not the public convenience and necessity requires that service should be continued to the existing customer.

While the limitation on price, to a rate that recovers only properly allocated costs, precludes differentiating among customers offering the maximum rate, there need be so such limitation as to length of the contract term. Other things being equal, a pipeline would prefer a longer term contract for service at the maximum rate than a shorter term. Other things being equal, the satisfaction of long-term transportation needs should have priority over the satisfaction of shorter-term needs. Accordingly, the Commission sees no reason to establish some maximum contract term, beyond which existing customers would not have to obligate themselves in order to retain firm capacity. This is particularly true in view of the capacity releasing mechanism adopted in the final rule which establishes a mechanism for the firm shipper to release unused capacity.

c. Mechanics of the process—post-restructuring proceedings. Many parties have asked the Commission to clarify the mechanics of exercising the right of first refusal that will apply after the initial restructuring proceedings. For example, several ask whether customers have one opportunity to bid or if it is an iterative process.[269] Kansas Power and Light Company suggests that the capacity holder should be able to wait until the bidding process is completed and then decide whether to match the most favorable bid.

At the outset, the right of first refusal is not a new, untested concept in gas regulation. The NGPA provided rights to purchasers of certain gas removed from the Commission's jurisdiction. Section 315 of the NGPA provides for a right of first refusal at the expiration of a contract for the first sale of natural gas to the person who, but for deregulation, would have been entitled to receive the gas. The right of first refusal under the NGPA gives the original purchaser the right to match the terms of a third party offer to purchase the gas at the expiration of the contract. If the original purchaser to match the terms of the third party offer, then the seller could sell the gas to the third party under the terms of the offer. Once the gas had been sold to the third party pursuant to the offer, the seller had no further obligation to the original purchaser.

The right of first refusal under this order will work similarly. When the contract is nearing expiration, the pipeline may seek offers from other persons interested in receiving the transportation. As discussed above in connection with capacity releasing, the pipeline is required to post available capacity and terms and conditions on its electronic bulletin board. If several offers are received, the pipeline will select one of the offers as the offer it will accept if the existing customer chooses not to match its terms. The pipeline will then present this offer to the existing customer, which, if it chooses to match the terms of price and duration, will continue to receive the transporation service from the pipeline. If the existing customer elects not to match those terms of the offer, then the pipeline must provide transportation service to the third party under the terms of the offer. If, in fact, transportation is not provided pursuant to the offer with respect to both rate and term, then the original customer is entitled to continued service at the pre-existing rate.

Offers may present different benefits to the pipeline. For example, a pipeline could receive an offer to purchase transportation for a period of five years at the maximum lawful rate, and a second offer to purchase transportation for ten years at a rate less than the maximum. The Commission is not specifying in this order the appropriate method of determining which is the "best" offer. The parties must consider methods of evaluating offers, such as, for example, calculating net present value, in the restructuring proceedings. The mechanics of the right of first refusal must be developed in the restructuring proceeding and set forth in the tariff including a provision that will implement an appropriate method of determining which is the "best" competing offer.

d. *Bona Fide Offers.* Other commenters [270] are concerned about the integrity of the right-of-first-refusal process. They fear that pipeline affiliates could artificially bid up the transportation rate. They assert that the standards of conduct applicable to pipelines with marketing affiliates, and the NOPR's proposal to apply those standards to pipelines' marketing divisions, would not prevent this, and state that the pipeline should be required to demonstrate than an offer is *bona fide.*

As discussed above, parties can protect themselves from these concerns through contractual provisions. However, the Commission recognizes that disputes may arise about whether a third-party bid for capacity under an expired contract is *bona fide.* Parties to the restructuring proceedings should address this issue and develop procedures for distinguishing between *bona fide* and spurious offers. For example, it may be appropriate for a third-party bidder to post a bond, or pay a reasonable "down payment" when it tenders its bid.

e. *Offers for a portion of existing customer's capacity.* TransCanada Pipeline, Ltd. asks the Commission to clarify that when an existing customer exercises its right of first refusal to retain capacity under an expiring contract the competing bidder must bid for all of the capacity under the existing customer's contract, not just a portion of it. If, for example, and LDC had a contract demand of six million MMBTu's per day under an expiring contract, any competing bidder would have to bid on all of the capacity under the contract to trigger the LDC's obligation to match the offer in order to retain the capacity. If a competing bidder sought anything less than the total capacity under the expiring contract, the existing customer could ignore the offer and retain the capacity.

The Commission clarifies that competing bids must be matched by existing customers, even if they are for less than the total capacity reserved under the existing customer's contract. The policy urged by Transcanada would virtually insulate the very largest holders of transportation capacity from the bidding process. On the other hand, the fact that a competing bidder has bid the maximum rate for a very long term for only a portion of the capacity under an existing customer's contract does not mean that the existing customer must match that offer for the remaining capacity. The existing customer need only match the competing bid for the amount of capacity to which the bid applies. If, for example, there are no other bids for the remaining capacity, the existing customer would simply proceed to negotiate the terms of a renewed contract for that capacity with

[269] *E.g.*, Interstate Power Co. and New Jersey Natural Gas Co.

[270] *E.g.*, Midwest Energy, Inc. and Distributors Advocating Regulatory Reform.

the pipeline, without regard to the terms it had to match to retain the capacity for which there was a bid.

f. *Converted sales.* As explained above, in *AGA II,* the court remanded the issue of pregranted abandonment of transportation service under § 284.221(d) of the Commission's regulations. On remand, in Order No. 500–J,[271] the Commission stayed the operation of this regulation where a customer converts firm sales service to firm transportation service after February 13, 1991.[272] The result was that these converted transportation arrangements would never be subject to pregranted abandonment and may be abandoned by the pipeline only upon receipt of Commission approval under section 7(b) of the NGA.

Several commenters ask the Commission to clarify that conversions that have occurred during the effectivenes of the stay of pregranted abandonment under Order No. 500–J will never be subject to pregranted abandonment, nor have to exercise a right of first refusal to avoid pregranted abandonment. These parties note that while the NOPR states that transportation converted from sales during the period the stay is in effect would remain subject to traditional section 7(b) abandonment, the text of the proposed regulation does not reflect this.

The Commission clarifies that conversions that took place during the effectiveness of the stay, *i.e.,* from February 13, 1991, to the effective date of the regulations promulgated in this order, will never be subject to pregranted abandonment. The revised § 284.221(d) specifically so provides. The Commission will require the pipelines to notify the Commission of all transportation arrangements that resulted from conversions during this stay in each pipeline proceeding implementing this rule. The stay is terminated on the effective date of this order.

Peoples Natural Gas Company argues that this provision discriminates in favor of conversions that took place during the effectiveness of the stay. However, the Commission finds that no one is aggrieved by this provision because, as explained above, the parties can defer pregranted abandonment by including an evergreen or roll-over clause in the contract. Absent such provisions, customers are protected by the right of first refusal. In sum, the rule contains sufficient safeguards so that customers that convert under these rules can be in essentially the same position as those that converted during the interim period.

XI. Transition and Implementation in the Restructuring Proceedings

The Commission recognizes that the natural gas industry cannot get to the new regime required by this rule in an instant. Contracts, and certificate obligations, will have to be renegotiated, revised, and in some cases, terminated. Pipelines will have to design rates to reflect their restructured services and incorporate the straight fixed variable rate design method. The transition to fully unbundled pipeline services will entail certain costs, and pipelines will need to propose mechanisms for recovery of those costs during the transition period. In this section, the Commission will discuss some of the issues that arise in connection with the transition, and the schedule and procedures to be used for an orderly and expeditious implementation of this rule.

A. Adjustment of Purchase Obligations and Firm Capacity

1. The Need for Adjustments

The restructuring required by this rule will result in significant changes to pipelines' services and rate structures, so that contractual commitments by pipelines and their customers must be subject to reevaluation and possible adjustment in view of those changes. Contracts entered into under significantly different regulatory conditions than those established by this rule, and under market conditions that in many cases were substantially different than today's, cannot be presumed to be just and reasonable under the regulatory structure established by this rule. Thus, pipelines and their customers that entered into long-term sales agreements when there were few if any reliable alternatives for the customers, or long-term firm transportation agreements, will have opportunities to adjust their commitments in light of the new commercial realities established by this rule and current market conditions.

The Commission finds that the continued enforcement of a pipeline sales customer's purchase obligations, agreed to before implementation of unbundling under this rule, is unjust and unreasonable, and unduly discriminatory. Therefore, during the restructuring proceedings established by this rule, unbundled sales customers will be permitted to reduce or terminate, in whole or in part, their purchase obligations under contracts with their pipeline suppliers. Such contracts were entered into when the pipeline had a virtual monopoly over the provision of reliable "no-notice" sales service, because of the unavailability to other shippers of the storage and load balancing services necessary to provide such service, and the numerous restrictions placed on transportation service for gas sold by nonpipeline merchants. Customers are therefore authorized to reduce or terminate their sales purchase obligations under such contracts as a remedy, to afford them access to the competitive gas market, and the Commission is granting pipelines abandonment authority to reduce or terminate their sales obligations in accordance with their customers' elections.[273]

In addition, with the conversion to unbundled transportation and sales services current pipeline firm sales and transportation customers may decide that they no longer need to retain the same quantity of firm transportation as previously. Most firm capacity holders under existing contracts are obligated to pay the maximum transportation rate. Thus, existing firm capacity holders will need to reassess their future needs for capacity. As a result, the customer may no longer need the same level of transportation from a certain pipeline, for example, because of capacity that becomes available on another pipeline. As another example, a current sales customer may decide that after conversion to unbundled firm transportation and unbundled sales it no longer needs, or wants, to maintain firm capacity rights from the beginning to the end of the mainline, but rather, only needs firm rights from a certain pooling point or market center that may be developed during the restructuring proceeding.

During the restructuring proceedings all firm capacity holders must reexamine the amount of firm capacity that they will need, or want, to continue to hold in light of the new services and rates to be developed to comply with this rule. Also, in order for the pipeline to develop the rates and range of services it will offer after restructuring, it will need to know whether and how

[271] III FERC Stats. & Regs. ¶ 30,915 (1991).

[272] *Id.* at p 30,083.

[273] Without the assignment of supply contracts, which must be done without undue discrimination, a customer's reduction in purchase obligations will likely result in the incurrence of costs by the pipeline. The pipeline will have the opportunity to recover these costs, either in the form of reservation fee surcharges on future transportation service, a negotiated "exit fee," or some combination. To avoid these charges or fees, the Commission strongly urges the customers to enter into negotiations to assume supply contracts. See *infra,* under discussion of transition costs and recovery mechanisms.

much capacity its current firm capacity holders will continue to hold. Therefore, all firm capacity holders must participate in the restructuring proceedings and notify the pipeline of the amount of capacity they intend to continue to hold after restructuring.

Capacity that is no longer wanted by the current holders can be reallocated during the restructuring proceedings as follows: All firm capacity holders must notify the pipeline of the amount of capacity they intend to retain after restructuring, at the pipeline's proposed maximum rate or at an existing discounted rate, if no other shipper is prepared to bid for that capacity.[274] Where the pipeline has a queue for firm service, the pipeline must notify the current firm capacity holder if another shipper is prepared to bid more than the current capacity holder pays for that capacity. In that event, if the firm capacity holder is unwilling to pay up to the maximum rate to retain its existing capacity rights, the firm capacity holder must give notice that it wants to reduce or terminate its contractual rights to firm service. If the capacity holder makes that election, the pipeline is granted an automatic abandonment of its service obligation under Section 284.14(e) to the extent of such reduction or termination, so that it can reallocate the capacity to another shipper. This mechanism can be invoked unilaterally by an existing firm capacity holder to relinquish all or a part of its firm capacity *only* if there is a demand for the capacity and another shipper is prepared to bid for that capacity. Where there is no competing bidder for the capacity, the existing customer's rights and obligations under the existing contract are unaffected, since this provision is designed only to ensure an efficient allocation of capacity where there is unsatisfied demand for the capacity. Thus, it provides a limited opportunity for transportation CD reductions.

However, if an existing firm capacity holder wants to relinquish all or part of its existing capacity, but there are no competing bidders, nothing in the final rule precludes the pipeline and the capacity holder from negotiating CD reductions. For example, the pipeline and the shipper may agree to terminate or reduce CD upon the capacity holders' payment of a reasonable exit fee.[275] If this occurs the Commission will give effect to this agreement, including effectuating the parties' deal by granting abandonment of the pipeline's obligation.

Where there is unsatisfied demand for capacity, a firm capacity holder should not continue to receive service at a discounted rate, if another shipper is prepared to bid more, up to the maximum rate, for that capacity. Unless the pipeline is contractually precluded from charging the maximum rate, when there is unsatisfied demand for capacity, the pipeline must charge the highest price (up to the maximum rate) bid for that capacity. Any other pricing behavior is inefficient and unduly preferential to the shipper receiving the discount. Therefore, while the Commission will not adopt the proposal contained in the NOPR, during the restructuring proceedings, pipelines must reduce or eliminate any discounts up to the maximum rate for firm transportation in such circumstances, unless the pipeline is contractually precluded from charging the maximum rate.[276]

The maximum rate, up to which a current firm shipper must be prepared to pay where there is unsatisfied demand for the capacity, is the maximum rate the pipeline is authorized to charge the current firm shipper for delivery to that shipper's existing delivery point. A competing bidder must be prepared to pay up to the maximum rate the pipeline is authorized to charge the competing bidder for delivery to that bidder's proposed delivery point. The current firm shipper only needs to bid up to its maximum rate.

Where the parties have negotiated and included in their contract either a fixed rate or some permanent form of discount, such as ninety percent of the maximum rate, the Commission recognizes the importance of giving effect to each party's respective contract rights. This is consistent with the general purposes of this rule, to give parties the ability to control their transactions as much as possible through their contracts. Where such contracts exist, the Commission recognizes that it is not unduly preferential for the pipeline to continue to charge the discounted rate.

To facilitate this capacity reallocation process, the Commission has included in this rule a special abandonment provision to permit the reallocation of transportation capacity during the restructuring period. Generally, under § 284.221(d) the pipeline is permitted to abondon transportation service where a contract expires or is terminated by the parties. However, Order No. 500–J stayed the effect of that provision for certain firm contracts so that the pipeline would have to file individual abandonment requests for transportation service under those contracts. Under new § 284.14(e), the pipeline is granted automatic abandonment of its transportation obligations to correspond to any election by a current firm capacity holder to relinguish some or all of its existing firm capacity during the restructuring proceeding, as discussed above. This provision will permit the speedy abandonment and reallocation of transportation rights and obligations during the restructuring proceedings where the firm transportation rights were acquired during the period of the Order No. 500–J stay.

The Commission proposed in the NOPR that firm capacity holders could retain long-term transportation capacity under existing contracts only by exercising a right of first refusal during the restructuring proceedings, *i.e.*, by agreeing to match the price (up to the maximum) and most favorable (longest) term offered by any competing bidder. The purpose of this proposal was to require all parties to existing contracts for long-term transportation service and bundled sales service to re-evaluate their need for firm capacity in view of the new unbundled service options and restructured rates. The Commission has changed these provisions in this rule and has included a mechanism to facilitate the orderly reallocation of capacity as described above.

The NOPR also proposed to permit pipelines' unbundled firm sales customers to reduce or terminate, in whole or in part, their firm sales entitlements (purchase obligations) during the restructuring proceedings. The final rule incorporates that proposal without change. Only the sales customer has the option to reduce or terminate sales service, not the pipeline. A pipeline's obligation to provide sales service continues, to the extent its sales customer elects to continue receiving sales service, for the duration of the existing sales contract. The automatic abandonment of the pipeline's obligation to provide sales service, granted in § 284.14, only applies to the

[274] As discussed more fully below, certain shippers by contract are not obligated to pay the pipeline's maximum rate.

[275] An exit fee is reasonable if it provides compensation to the pipeline for all the costs attributable to the departing customer so that the pipeline will not seek to allocate any unrecovered balance of the costs attributable to the departing customer to remaining customers. *See* Northern Natural Gas Company, 59 FERC ¶ 61,003 (1992).

[276] Although the Commission may permit utilities to increase rates above the level agreed to in a fixed rate contract if it finds those rates so low as to adversely affect the public interest, *FPC* v. *Sierra Pacific Power Company*, 350 U.S. 348 (1956), there is no basis in the record of this proceeding for making generically applicable findings to that effect.

extent the pipeline's sales customers elect to reduce or terminate, in whole or in part, sales service from the pipeline during the restructuring proceeding. After the initial restructuring, the provisions of the new blanket sales certificate will apply.

Parties will have to make decisions concerning their rights to adjust their service under the provisions of this rule in the course of the restructuring process, which will necessarily be iterative. A pipeline will propose a menu of unbundled services after discussions to determine the needs of its customers and other interested parties. The pipeline will need to estimate the extent that customers will use the restructured services and develop *pro forma* rates to recover its cost of service. Customers will review the pipeline's proposed services and rates and estimate their levels of usage. The pipeline may need to revise its proposed rates, and perhaps its menu of services, in response to the initial indications of demand. Customers (or potential customers) that want additional transportation capacity will submit bids for the capacity at rates within the maximum and minimum rates proposed by the pipeline. As the process nears completion, sales customers will have to elect whether to continue buying gas from the pipeline on an unbundled basis at the same level as under their existing contracts. As described above, all long-term firm capacity holders (including formerly bundled sales customers) must notify the pipeline of the capacity they intend to retain, reduce, or terminate. In the end, gas supply and capacity will be reallocated in accordance with the needs of customers in an unbundled environment, where customers will have a range of choices not previously available.

The Commission expects and requires all parties—pipelines, producers, LDCs, end-users, state commissions, and others—to participate in the restructuring proceedings to reach this objective. Moreover, the Commission will require the discussions taking place during the restructuring proceedings to be conducted in an open and nondiscriminatory manner as to all parties. However, the Commission will permit restructuring discussions to take place outside of the Commission's offices.

2. Discussion of Comments

Many LDCs and industrial customers objected to the proposal to jeopardize their long-term transportation arrangements by requiring them to match competing bids to retain capacity. Some LDCs argue that this procedure will drive up their costs by forcing them to compete with industrial bidders that do not have any public service obligation.[277] Many industrial customers and electricity generators protest the prospect of having to pay higher rates after having structured financial arrangements on the basis of negotiated transportation rates, especially those that have recently negotiated long-term contracts for firm transportation service at discounted rates.[278]

These provisions have been changed in the final rule. However, the Commission's goal is still to effect a more efficient allocation of capacity. Where the demand exceeds available capacity, and another shipper is prepared to bid up to the maximum rate for that capacity, the pipeline must charge the highest rate bid up to the maximum fully allocated, cost-based rate for the capacity. If existing capacity holders have not negotiated fixed discounted rates for that capacity, then they must be prepared to pay up to that rate or release the capacity to other shippers that are willing to pay up to the maximum rate.

As noted above, most LDCs with contracts for bundled sales service are currently paying fully allocated, cost-based rates for the embedded transportation service, which is the equivalent of the maximum rate for open access transportation. For capacity converted under the transitional provision of this rule (18 CFR 284.14), the only question is whether LDCs will have the opportunity to negotiate for a discounted transportation rate in the process of the pipeline's unbundling and restructuring. If there are competing bidders willing to pay the maximum rate for the capacity, the LDCs will not have that opportunity. If there are no competing bidders, or none willing to offer the maximum rate, LDCs can negotiate for a discounted rate. All other shippers with firm transportation capacity at discounted rates will also have to match competing bids, unless they have fixed-rate contracts. If shippers have long-term contracts for firm transportation with fixed-rate provisions that are below the maximum rate, they will not have to pay the maximum rate or match competing bids to retain their capacity. Nor will customers that receive transportation under individual certificates, rather than part 284 open access blanket certificates, have to match competing bids, because the provisions of this rule do not apply to such service.

The Panhandle Pipeline Group argues that there are no findings or facts to support the proposal to permit sales customers to have the unilateral right to reduce their purchase obligations under their sales contracts, and note that the Commission's attempt to allow such unilateral reductions in Order No. 436 were expressly rebuffed by the court in *AGD I.*[279] Pacific Gas Transmission Company urges the Commission to honor all existing firm service agreements between pipelines and their customers, absent a case-specific finding that a particular contract is unduly discriminatory, or otherwise anticompetitive or contrary to the public interest. Natural characterizes the proposal in the NOPR as giving a pipeline's customers the right to abrogate existing firm sales contracts with their pipeline suppliers, which it opposes as one-sided and disruptive. Columbia and Natural argue that if customers have the right to revise their contractual obligations to purchase gas, pipelines should also have the right to reduce or eliminate their obligations to sell gas.

Columbia states that its primary concern with the NOPR involves the one-sided nature of the contract renegotiation process for sales service. Columbia notes that pursuant to its recent global settlement,[280] Columbia entered into sales agreements with its wholesale customers to provide approximately 360 Bcf of sales service annually through the year 2004. Under the terms of the NOPR, according to Columbia, its sales customers would be able to pick and choose the precise level of sales service they desire, while Columbia would not be given any similar opportunity.

Natural points out that it entered into new contracts effective December 1, 1990, at a time when the essential framework of open access transportation was in place on its system. Natural asserts that the new contracts are for limited terms of not more than five years, and that it has made (or retained) supply commitments with producers based on these sales

[277] *See, e.g.*, Citizens Gas and Coke Utility, Interstate Power Company, Panhandle Customer Group, and UGI Corporation.

[278] *E.g.*, Midland Cogeneration Venture Limited Partnership, New England Power Company, Southern California Edison Company, Thermo Electron Corporation, Agricultural Mineral Corporation, The Fertilizer Institute, Mississippi Chemical Corporation, Process Gas Consumer Group *et al.*, and Reynolds Metals Company.

[279] *Associated Gas Distributors* v. *FERC*, 824 F. 2d 981, 1013–21 (D.C. Cir. 1987) *cert. denied sub nom.*, Interstate Natural Gas Association of *America* v. *FERC*, 485 U.S. 1006 (1988).

[280] See Columbia Gas Transmission Company, 49 FERC ¶ 61,071 (1989), *reh'g denied*, 51 FERC ¶ 61,194 (1990).

contracts with its LDCs. According to Natural, the Commission's "wholesale abrogation" approach tests the limits of the Commission's authority, and undermines the confidence of parties in the efficacy of contracts subject to regulation by the Commission. Natural argues that if customers abrogate these contracts pursuant to the final rule, Natural should be guaranteed total recovery of any resulting costs.

The Commission recognizes that the customers of Columbia and Natural may have had more choices than some other customer groups during the recent, post open-access renegotiations of sales contracts. Nevertheless, neither Columbia nor Natural currently offers fully unbundled transportation and storage services of a quality equal to that embedded in their firm sales service. Thus, their customers were still subject during the recent contract negotiations to the pipelines' monopoly over reliable, no-notice delivery service for which the customers' right to adjust purchase obligations is a remedy.

However, the Commission has crafted a rule that balances the interest of the pipelines and their customers by permitting pipelines to abandon firm sales obligations where customers elect to reduce or terminate purchases, and to recover 100 percent of any gas supply costs, as Natural urged, incurred as a result of their sales customers' elections. Knowing that the pipelines will be entitled to 100 percent recovery of the costs of realigning their gas supply contracts (described *infra*), purchasers must exercise considerable prudence in deciding whether to exercise their rights under this rule to reduce or terminate their purchase obligations. This is an area where cooperation between a pipeline and its sales customers can minimize the transistion costs. For example, customers can postpone the effective date of their reductions of purchases from the pipeline to correspond to the term of certain of the pipeline's producer supply contracts that would have to be renegotiated, thus giving rise to transition costs, if the customers terminate purchases. However, the customer will be making these decisions in the context of the restructuring proceeding. In order for these choices to be meaningful, the pipeline must put on the table the full range of unbundled services, and the estimated rates for those services, that it expects to offer to comply fully with the final rule. Only then can customers make rational choices and elect the services that meet their needs.

B. Transition Costs and Recovery Mechanisms

1. Summary and Rationale

The Commission recognizes that pipelines will likely incur costs as a result of implementing the requirements of this rule. The issues are how, to what extent, and from whom, should the pipelines recover those costs.

The Commission envisions four types of costs. The first type are the unrecovered gas costs (or credits) remaining in the purchased gas adjustment (PGA) Account. 191 when a pipeline adopts market-based pricing for its gas sales and terminates its purchased gas adjustment mechanism (the "Account No. 191 balance"). The second type of costs may result from the pipelines realigning their existing gas supply contracts with producers in connection with implementing this rule ("gas supply realignment costs"). A third type are the costs of a pipeline's assets now used to provide bundle sales service, such as gas in storage, and capacity on upstream pipelines, that cannot be directly assigned to customers of the unbundled services ("stranded costs"). A fourth type consists of costs associated with physically implementing the rule (*e.g.*, meters, valves, communications equipment) ("new facility costs").

Under market-based rates, the pipeline would no longer recover gas costs through a PGA mechanism, but it may have unrecovered gas cost in Account No. 191 when it discontinues that recovery mechanism. The Commission will permit pipelines to "direct bill" the Account No. 191 balance to their former bundled, firm sales customers, as proposed in the NOPR, whether or not the customers elect to continue as firm sales customers on an unbundled basis after implementation of this rule. The unrecovered gas costs should not be billed to customer who are not sales customers during the period when liability for the direct bill is established, because the gas purchase costs are not incurred for them and they would not have to pay those costs if the PGA were to continue. Furthermore, customers would have the right to challenge the prudence of the gas purchases reflected in the Account No. 191 balance.[281]

The unrecovered gas costs are not future costs incurred to comply with the rule, but are costs incurred prior to implementation of the rule.[282] The Commission's proposal in the NOPR that the underrecoveries in Account No. 191 would be direct billed put pipeline customers on notice that they would have to pay any such costs accured after July 31, 1991, the issuance date of the NOPR. The Commission reiterates that pipeline firm sales customers will be responsible for unrecovered gas costs in Account No. 191 accrued prior to implementation of this rule. Customer responsibility for commodity-related Account No. 191 costs may be based on their gas purchases for the twelve months preceding the effective date of service under the pipeline's unbundled sales certificate (granted under § 284.284), and for unrecovered demand charges in Account No. 191, based on contract entitlements on the day preceding that effective date.[283] The pipelines must permit customers to pay the direct bill in either a lump sum, over twelve months or over some other reasonable period of time, at the customer's option.[284] Of course, a pipeline must refund any overrecoveries in its Account No. 191 and flow through to its customers any refunds it receives that are attributable to the relevant past period.

The second type of costs, gas supply realignment costs, may result from the pipelines having to reform to market levels, or terminate altogether, their existing supply contracts with producers in connection with implementing this rule. The Commission will permit pipelines full cost recovery of prudently incurred gas supply realignment costs deemed to be eligible under this rule. To recover those costs, a pipeline will be permitted to use either a negotiated exit fee, or a reservation fee surcharge recoverable from part 284 firm transportation customers.

Under this rule, a firm entitlement holder has options as to how to react to gas supply realignment costs: It may remain a sales customer of the pipeline; otherwise, it may take an assignment of the pipeline's existing contracts pay an exit fee/reservation fee surcharge for costs approved by the Commission. To mitigate any transition costs that may arise, the Commission strongly

[281] See Transcontinental Gas Pipe Line Corp., 46 FERC ¶ 61,364 at p. 62,147 (1989).

[282] The costs are incurred prior to implementation when the gas is taken prior to implementation, even though paid for afterwards. For example, there may have been a billing disput. See *Id.* at p. 62,147.

[283] Pipelines or other parties to the restructuring proceedings may propose other mechanisms if the above described mechanism is inequitable—if for example, there are large underrecoveries but very few customers were making purchases during the base period.

[284] Transcontinental Gas Pipe Line Corp., 46 FERC ¶ 61,364 at p. 62,147 (1989); Northwest Pipeline Corp., 45 FERC ¶ 61,224 (1988), *reh'g granted in part*, 46 FERC ¶ 61,091 (1989).

recommends assignment of gas supply contracts. Unless the specific gas supply contracts prohibit assignment, the pipeline would assign those contracts on a non-discriminatory basis to those who choose to receive assignments.[285]

If there are excess gas supply contracts held by the pipeline after assignment, the pipeline should realign those contracts. Where the pipeline remains in the merchant business, it should realign its portfolio to leave it a market responsive level, enabling it to compete on a even basis with any other merchant. The Commission, in a section 4 filing by the pipeline to recover gas supply realignment costs, will perform two levels of review.

The first level will be an eligibility review to determine whether the resulting realignment costs are attributable to events which occurred independently of the final rule, or whether they are attributable to the implementation of the final rule. That proportion of gas supply realignment costs which are determined to be attributable to the final rule will be eligible for 100 percent cost recovery if the Commission finds that the costs were prudently incurred. If the Commission finds that a portion of the gas supply realignment costs are attributable to events that are independent of the final rule, then it will treat such costs accordingly and continue the use of the recovery mechanism developed in Order No. 528. Where the total sum of gas supply realignment costs is partially eligible and partially non-eligible, parties should devise an allocation method which divides the costs among the two recovery mechanisms proportionately.

The second level of review will be for prudence. In any rate filing, all costs are subject to prudence review; the Commission is not proposing a new standard under this rule. The Commission's primary objective in any prudence review of gas supply realignment costs will be to determine that the total amount is as minimal as possible. Elements of this determination should include, but not be limited to, the following: Whether the contract terms were reasonable in light of the market conditions existing when the contract was negotiated, renegotiated or terminated, whether the contract realignment costs resulted from vigorous arms-length negotiations, and whether there was a *bona fide* effort on the part of both parties to the contract to arrive at a settlement.

The Commission will permit prudently incurred gas supply realignment costs to be recovered by use of a reservation fee surcharge or an exit fee. A surcharge mechanism will be in addition to a pipeline's reservation charge for firm transportation and storage services, and will thus be recoverable from all part 284 firm transportation customers. The surcharge will not be applicable to interruptible transportation service or transportation under individual NGA section 7(c) certificates. Parties may also negotiate for the payment of an exit fee, in lieu of, or in combination with, a reservation fee surcharge. The exit fee could be a cash payment made by a sales customer that reduces or terminates its sales obligation during the restructuring proceeding.

The pipeline and interested parties may negotiate allocation of gas supply realignment costs among the pipeline's various firm services in the restructuring proceedings. The Commission will not specify a method for allocating such costs. Although the Commission will not require a sunset date for a reservation fee surcharge for gas supply realignment costs, all parties to the restructuring proceedings are encouraged to consider terminating the surcharge on a date certain.[286]

In the NOPR, the Commission noted that take-or-pay costs and buyout/buydown costs have been recoverable under the provisions of Order No. 528, where pipelines agree to absorb at least 25 percent of such costs, unless the pipeline has implemented a market-based price for its gas sales. The NOPR proposed that pipelines be able to continue to seek recovery of such costs through an Order No. 528 mechanism after restructuring, if they did not implement a market-based price for gas sales. The NOPR sought comment on whether some other mechanism would be more appropriate, with or without an absorption requirement, for recovery of gas supply realignment costs that result from compliance with this rule.

After considering the comments on this issue, the Commission has concluded that pipelines should be entitled to recover 100 percent of their prudently incurred gas supply realignment costs that result from compliance with this rule. However, the Commission will not allow the pipelines to recover 100 percent of the costs until the Commission determines they have fully complied with the final rule. Thus the policies of Order Nos. 500 and 528, under which pipelines absorbed a percentage of take-or-pay costs will generally not be applicable to recovery of gas supply realignment costs attributable to this rule,[287] although the policies of Order No. 528 will continue to apply until the pipeline fully complies with the provisions of this rule.

The policies of Order Nos. 500 and 528 were designed to encourage pipelines to share some of the cost of the extraordinary take-or-pay liabilities of the early and mid-1980's. The Commission does not anticipate that pipeline gas supply costs that are incurred as a result of implementing this rule will approach the order of magnitude of the take-or-pay liabilities of that era. For one thing, pipelines should now have gas supply contracts that are more responsive to the pipelines' markets. Customers will undoubtedly weigh the effects of paying the gas supply realignment costs in deciding whether to reduce their purchase obligations to pipelines under currently effective contracts or to take assignment of their share of the pipelines' current contracts. Although pipelines will not be asked to bear any prudently incurred gas supply realignment costs they will incur as a direct result of the restructuring required by this rule, they will not be afforded protection from challenges to their prudence in this matter.[288]

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[285] Although the Commission will not prescribe a certain assignment/allocation mechanism, it expects the parties to adhere to non-discriminatory principles that will result in equal treatment for all potential assignees regardless of whether they are sales customers of the pipeline. The Commission expects assignments to minimize the costs that will be recovered in a reservation fee surcharge to the fullest extent possible.

[286] While not imposing a sunset date, the Commission will, three years after the effective date of this rule, audit each pipeline's remaining gas supply contracts to ensure that the pipeline has sought, with due diligence, to realign its contracts to reflect its obligations brought about by this rule. If pipelines and their customers agree to a sunset date for filing for recovery of new gas supply realignment costs within this three year period, the Commission will not audit that pipeline's gas supply contracts.

[287] On the other hand, if a pipeline has filed for recovery of take-or-pay or contract realignment costs under Order No. 528, the policies of that order continue to apply to those costs. Such costs may not be recharacterized as costs attributable to the requirements of this rule.

[288] Nor should LDCs' actions in restructuring proceedings be exempt from prudence challenges under applicable law in proceedings before state regulatory commissions. As the Commission stated in Order No. 528–A: "[I]ts action in authorizing interstate pipelines to charge LDCs for take-or-pay costs should not be viewed as preventing action by the state commissions to require partial absorption of those costs by LDCs in accordance with federal and state law." Mechanisms for Passthrough of Pipeline Take-or-Pay Buyout and Buydown Costs, 54 FERC ¶ 61,095 at p. 61,308 (1991). See also Kentucky West Virginia Gas Co. v. Pennsylvania Public Utility Commission, 837 F.2d 600 (3d Cir. 1988), *cert. denied*, 488 U.S. 941 (1988); and Pike County Light and Power Company v. Pennsylvania Public Utility Commission, 465 A.2d 735, 737–738 (1983).

The third type of costs, stranded costs, are costs now incurred by pipelines in connection with their bundled sales services that cannot be directly allocated to customers of the unbundled services. For example, pipelines may retain unclaimed or unneeded upstream pipeline capacity even after assignment of portions of that capacity to their firm transportation customers. Similarly, the pipelines may have unbooked, open-access, contract storage beyond their storage needs for balancing and system management.

Stranded costs and the fourth type of costs, for new facilities, should be treated like all other prudently incurred costs, and the pipeline should file to recover such costs in a general rate filing under NGA section 4. Including new facilities costs and stranded costs for consideration in a general rate case will permit a full review of their legitimacy, and case-specific decisions on how to allocate these costs. While the Commission anticipates that most of the costs of new facilities would be includable in rate base, and therefore affect reservation fees for transportation services or the demand charge component of other services, there is no way of anticipating the nature and amount of the stranded costs, and thus no way at this time of devising an appropriate billing mechanism on a generic basis.

2. Discussion of Comments

Most of the commenters, including LDCs, support the ability of the pipelines to recover 100 percent of their prudently incurred transition costs, although no commenter proposed any specific, detailed, cost recovery mechanism.[289] Virtually all of the comments on transition costs addressed gas supply costs. Pipelines propose that recovery of gas supply costs, incurred to realign contracts with producers as a result of implementing this rule, should be through a direct bill or exit fee, not through a commodity surcharge, which they argue would put them at a disadvantage in a highly competitive market.[290] Producers also favor a direct bill mechanism, arguing that volumetric surcharges will result in lower netback prices to them.[291] On the other hand, LDCs and state commissions generally favor volumetric surcharges, and oppose direct bills, which they argue will encourage bypass by large industrial end users.[292] The California Public Utilities Commission argues for partial absorption of gas supply costs by pipelines as an incentive to minimize transition costs. Several LDCs propose that the Commission authorize pipelines to amend their contracts with producers to avoid the costs of supply no longer needed as a result of restructuring, and some suggest that producers' access to transportation service should be conditioned on granting the pipeline relief from its contractual obligations for such supply.[293]

The Commission is authorizing 100 percent recovery of prudently incurred gas supply realignment costs incurred as a result of the full implementation of the rule because of the further significant industry-wide restructuring imposed by the Commission in this rule. Any indication that pipelines were lax in their efforts to minimize gas supply realignment costs will be subject to a challenge for prudence and careful scrutiny by the Commission, as discussed above. In Order No. 500 the Commission adopted rules to allow the pipelines to recover prudently incurred contract reformation costs. That program has been in place for over four years. Indeed, the Commission has found that the take-or-pay problem has been "substantially resolved." [294] The Commission is strongly encouraging pipelines to take additional steps, as soon as possible, to realign their obligations to sell gas resulting from customer choices brought about by this rule.

Pipelines must be able to show that any gas supply realignment costs for which they seek 100 percent recovery are attributable to their actions taken in response to this rule, and that such costs have been minimized by vigorous arms-length negotiations with their producer/suppliers. Thus the possibility of having to defend the incurrence of such costs, and suffer disallowance of recovery, should provide sufficient incentive for pipeline diligence in minimizing these costs.

A fixed surcharge on firm transportation reservation rates is selected (traditionally called a "demand surcharge"), because it passes through the pipeline's costs of adjusting its gas supply inventory to the customers whose choices give rise to the costs, and the customers that will benefit from the unbundling and restructuring required by this rule. The reservation fee surcharge mitigates some of the "net-back" effect on wellhead prices of a volumetric surcharge on all throughput, which might jeopardize the ability of producers to develop new gas supplies by lowering wellhead prices even more than current market conditions have already. The Commission has already explained in detail in Order Nos. 500–H and 500–I why it does not choose to try to revise producer contracts under NGS section 5.[295] While in Order No. 500–H, the Commission conditioned producers' access to transportation service on their willingness to give the pipelines certain credits against the pipelines' take-or-pay obligations, the Commission is very reluctant to create disincentives to producers to market their available reserves to willing buyers by requiring them to relinquish their contractual rights, or placing other conditions on their access to willing buyers in the marketplace.

Several LDCs and state commissions ask that an LDC not be assessed transition costs attributable to former industrial customers that have by-passed their system, and now receive service directly from the interstate pipeline that serves the LDC.[296] The Commission will consider requests from LDCs for two forms of relief, where they can show a direct nexus between the by-pass and the costs at issue: (1) A reduction in an LDC's contract demand and reservation fee charges, with the industrial customer picking up the LDC's reduced portion directly, and (2) a transfer from the LDC to the industrial customer of the LDC's share of transition costs that are attributable to that customer. Although the Commission has denied similar requests for relief in the past,[297] and will not grant generic

[289] See, *e.g.*, Associated Gas Distributors, Brooklyn Union Gas Company, and United Distribution Companies.

[290] *E.g.*, Enron Interstate Pipelines, National Fuel Gas Supply Corporation, Natural Gas Pipeline Company of America, Tenneco Gas, and Panhandle Eastern Pipeline Group.

[291] *E.g.*, Independent Petroleum Association of America, MESA Limited Partnership, Natural Gas Supply Association and Indicated Producers, and Yates Petroleum Corporation.

[292] *E.g.*, Distributors Advocating Regulatory Reform, Michigan Consolidated Gas Company, Northern Indiana Public Service Company, New England Conference of Public Utility Commissioners, National Association of Regulatory Utility Commissioners, and Alabama Public Service Commission.

[293] *E.g.*, City of Colorado Springs, Mobile Gas Service Corporation *et al.*, Northern Distributor Group, and Pacific Gas and Electric Company.

[294] Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, FERC Stats. & Regs. [Regulation Preambles 1986–1990] ¶ 30,867 at p. 31,523 (Order No. 500–H).

[295] Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, FERC Stats. & Regs. [Regulations Preambles 1986–1990] ¶ 30,867 (Order No. 500–H), *order on reh'g*, FERC Stats. & Regs. [Regulations Preambles 1986–1990] ¶ 30,880 (Order No. 500–I).

[296] Illinois Power Company, Tennessee Valley Municipal Gas Association, United Distribution Company, and Illinois Commerce Commission.

[297] See *Northern Illinois Gas Company* v. *Natural Gas Pipeline Company of America*, 47 FERC ¶ 61,396 (1989), 48 FERC ¶ 61,337 (1989), 49 FERC ¶ 61,098 (1989), 56 FERC ¶ 61,215 (1991).

relief here to LDCs in this situation, it will consider requests for such relief concerning future transactions in the context of the new regime of this rule on a case-by-case basis.

3. Great Plains Gas

The Dakota Gasification Company (Dakota), the current owner of the Great Plains Gasification Project, which operates a plant for the conversion of coal into synthetic natural gas, requests that a special billing mechanism be authorized for any of the pipelines that purchase gas from the project, if they terminate their PGA mechanisms and implement market-based pricing of gas under this rule. The synthetic gas from Great Plains is priced substantially above current market clearing prices. Dakota also requests that the firm transportation capacity on such pipelines used for transporation of the synthetic gas not be subject to abandonment in the restructuring proceedings. Dakota notes that the Commission recently approved a settlement in the restructuring proceeding of Transcontinental Gas Pipeline Corporation (Transco) that provided for a volumetric surcharge on system throughput to recover the above-market gas costs and associated transportation costs related to its obligations to purchase synthetic gas from Great Plains.[298]

There are three other pipelines that purchase synthetic gas from Great Plains—ANR Pipeline Company, Natural Gas Pipeline Company of America, and Tennessee Gas Pipeline Company. The Commission will consider any proposals in these pipelines' restructuring proceedings for a special billing mechanism and special treatment for the associated transportation capacity for Great Plains gas consistent with the precedent in the Transco proceeding.

C. Schedule and Procedure

1. Summary

As proposed in the NOPR, the Commission intends to rely initially on the parties in the restructuring proceedings on each pipeline system to work out the details of compliance with this rule. To this end, the Commission is instituting restructuring proceedings (the RS proceedings) for each interstate pipeline affected by this rule by means of the notice issued contemporaneously with this rule. Section 284.14 is added to the general provisions of part A of part 284, as a temporary provision to govern the implementation of this rule. The process of implementation thus begins with the issuance of this order and notice. Interested parties may file motions to intervene in each RS docket within 30 days after issuance of this rule. The pipeline or any other interested party may file a motion to consolidate the RS proceedings with any related pending proceedings within 45 days of issuance. In addition, if a pipeline believes that any part of its existing services, tariff provisions, and rates already comply fully with the provisions of this rule, it can inform the Commission at this time. The pipeline must support its belief with a detailed explanation of how its tariffs already comply with the different features of the rule. The Commission will act promptly to review any such claim so that the pipeline and other interested parties will know whether, and if so, what further action will be needed by the pipeline to fully comply with this rule.

No later than 60 days after issuance of this order, pipelines must initiate discussions on implementation of the rule with the intervenors in their assigned RS proceeding. Pipelines must serve each intervenor in their RS proceedings a summary of their proposals for full compliance with the rule, including *pro forma* rates, no later than 90 days after issuance of this order. Also, to facilitate timely and full compliance, the Commission's staff will convene a pre-filing conference in each RS proceeding, within a reasonable period of time after the pipeline's summary proposal has been served, but before the pipeline's deadline for making its complaince filing, to assist the parties in developing the full range of issues to be addressed on that system and structuring the shape of the compliance filings.

Each pipeline is assigned a deadline in the new § 284.14 and the companion notice for making its tariff filings to comply fully with this rule. The first group of filings will be due by October 1, 1992, and the three remaining groups of filings are due by November 2, 1992, December 1, 1992, and December 31, 1992, respectively. These compliance filings should be made earlier than these deadlines, if possible. The effective date (or dates) of the full implementation of each pipeline's compliance will be subject to Commission approval on a case-by-case basis. The Commission will issue an order on each compliance filing, either accepting it for implementation on a prospective basis or establishing appropriate procedures. A timeline showing this implementation schedule is appended to this order. The Commission expects to act on all compliance filings in time for all pipelines to implement this rule sufficiently in advance of the 1993–94 winter heating season to provide customers with an adequate opportunity and adequate time to schedule necessary services for that season.

2. Discussion

As discussed above, the Commission has found that the current regulatory structure, and in particular the pipelines' existing bundled, city-gate, firm sales service, is and will continue to be an unreasonable restraint of trade which causes competitive harm to all segments of the natural gas industry because, among other things, it provides the pipelines with an undue advantage and subjects other gas sellers to an undue disadvantage. Therefore, the Commission has found that the pipelines' bundled, city-gate firm sales service violates sections 4(b) and 5(a) of the Natural Gas Act. Accordingly, the Commission is adopting remedies that must be complied with as soon as possible to remedy the violations of the Natural Gas Act promptly and to eliminate the anticompetitive conditions that currently exist.

To that end, the Commission seeks to ensure that all pipelines will be in full compliance with the final rule for the 1993–1994 winter heating season. While the Commission anticipates that many pipelines will be able to implement all required elements of the final rule in advance of the 1992–93 winter heating season, other pipelines may not be able to formulate specific proposals and complete their negotiation with all interested parties as expeditiously for various pipeline-specific reasons. Meaningful implementation of this rule on each pipeline system will require existing sales and transportation customers, competing gas merchants, and other interested parties to have an opportunity to consider the various sales, transportation and storage services that will result from the final rule, and to work out the operational details with the pipeline, sufficiently in advance of the winter heating season to permit the development of strategies for meeting peak season demand. At least for some pipelines, it appears unlikely that implementation of this rule would be complete in time for the 1992–93 winter heating season. Therefore, while the Commission strongly encourages compliance with this rule this calendar year, on balance the Commission has concluded that it should not require full compliance with this rule until the 1993–94 winter heating season. This will afford the pipelines and interested

[298] Transcontinental Gas Pipe Line Corporation, 55 FERC ¶ 61,446 at p. 62,332 (1991).

parties enough time to work out the operational details and make all adjustments necessary. The Commission does not anticipate any reason for further delay in implementation.

Considerable benefit will be realized from implementation of the final rule by all pipelines in the same general time frame, rather than staggered over several years. A coordinated implementation can facilitate the development of market centers, the allocation of capacity between upstream and downstream pipelines and their users, and the allocation of storage facilities. It will also permit market participants to develop more options for the delivery of gas out of any given supply basin or into any given city-gate market using a single or multiple pipeline paths and storage combinations. Also, by starting now towards full implementation for the 1993–94 winter season, parties will be able to arrange for the full range of storage service options for that winter heating season, because the storage injection season begins as early as March 1, of the preceding spring for some pipeline systems.

Another side of enabling market participants to evaluate all service options contemporaneously, is that they can also evaluate all the costs associated with the available options, especially transition costs, and develop a strategy that will best mitigate the transition costs. In the Commission's view, reliance on well-informed customer choices is the best way to minimize transition costs, rather than delaying, deferring, or phasing-in critical elements of this rule.

The phasing-in of the requirements of this rule would not be consistent with the Commission's goals here. The unbundling of sales and transportation services makes it possible for the Commission to permit pipelines to sell gas under the blanket sales certificates on a basis analogous to unregulated sellers. It also enables the Commission to ensure that transportation and storage will be available for all gas supplies on equal terms. Unbundling in combination with the new no-notice transportation service, access to storage, the capacity release mechanisms, and other capacity adjustment mechanisms in this rule will enable market participants to function without the anticompetitive influences from the past regulatory environment. Unless these are all implemented in a generally contemporaneous time frame, past restrictions on the functioning of the market will continue, and the Commission's purposes here may not be achieved within a reasonable period of time. More importantly, these provisions must be implemented contemporaneously in order for market participants to be able to replicate the bundled service provided by pipelines today. These considerations have guided the Commission's development of the implementation procedures and schedule discussed below.

The notice issued contemporaneously with this order assigns an RS docket number to each pipeline restructuring proceeding. If a pipeline believes that its existing tariffs or settlements already filed with the Commission achieve the full objectives of this rule, or that a proceeding currently pending before the Commission constitutes an appropriate vehicle for its compliance with this rule, it must file a motion in the RS docket with the Commission within 45 days after issuance of this order, setting forth the basis for its belief and indicating whether it wants to terminate the currently pending proceedings, consolidate them with RS docket, or terminate the RS docket.

The Commission will act promptly to address any such requests, so parties can have the benefit of the Commission's views before they have to engage in discussion under the restructuring requirements of the rule. If the Commission agrees that any or all aspects of a pipeline's current services, tariff provisions, or rates comply fully with the rule, then there is no need for the parties to engage in the restructuring proceedings established here, or at least as to the aspects that already fully comply. The Commission may not be able to provide this guidance before the parties are required to begin discussion under the timetable established in this order. However, the Commission will endeavor to act on these filings as quickly as it can.

Motions to intervene in the restructuring proceedings after the pipelines' compliance filings to fully implement the rule are made will not be viewed with favor. The speed and success of implementation of this rule will depend largely on the involvement of all interested parties (including producers, shippers and potential shippers, marketers, state commissions, and end-users, as well as small-, large-, and medium-sized LDCs) in the discussions that will precede the pipelines' filings to comply with the rule, and the attempted intervention of interested parties after those discussions have culminated in the compliance filings will generally be disruptive.

The Commission encourages the pipelines to develop a consensus on, or substantial support for, their plans of full implementation before making the required restructuring filings, if possible. To this end, this order requires each pipeline affected by this rule to initiate discussions with its customers and other interested parties no later than 60 days after issuance of this order. Each pipeline must serve a summary of its proposed plan of full implementation to the intervenors no later than July 7, 1992, following the procedure used by the Commission's litigation staff for serving "top sheets" in a rate case. This summary must include a description of how the pipeline proposes to implement fully all aspects of the final rule, including any terms and conditions the pipeline proposes for maintaining operational control of its system and the reasons why the pipeline believes these are necessary, and *pro forma* illustrative rates for the restructured services.

Furthermore, the Commission is directing its staff to convene at least one conference in each restructuring proceeding prior to the pipeline's deadline for making its restructuring filing. These will be publicly noticed conferences, convened for the purpose of assisting the pipeline and interested parties in delineating the issues that need to be resolved in the pipeline's compliance filing and to discuss the structure of that filing. The conference in each proceeding should be convened no sooner than 90 days nor later than 180 days after issuance of this order. The conferences may be convened at locations that are convenient to the representatives of the pipeline and intervenors, not necessarily at the Commission's headquarters in Washington, DC. The Commission staff will report to the Commission, if needed, the status of pre-compliance filing discussions at the public conference to assist the Commission in identifying early any problems that may be hindering the full and timely implementation of this rule.

The nature of the pipelines' filings may vary somewhat, depending on the extent to which the pipeline has previously incorporated features required by this rule into its current tariff and portfolio of services. However, all of the pipelines' filings will be compliance filings pursuant to the Commission's findings and rulings in this final rule under section 5 of the Natural Gas Act (NGA), and authorizations granted under NGA section 7.

The Commission recognizes that some components of the restructured rates

will be higher than the same component (or an equivalent component) under existing rates. However, the pipelines are required to submit *pro forma* tariff sheets that are based on the same cost of service and total throughput as their currently effective rates. Thus, the restructuring will not result in any overall increase in rates. Where changes in rate design result in rate increases in certain components of the rates, or to certain customers or customer classes, the Commission will permit the increases in the compliance filing because it is related to a Commission directed modification in the pipeline's rate structure.[299]

Furthermore, pipelines may file notices of rate changes pursuant to Section 4 of the NGA in conjunction with their restructuring filings that have no direct relationship to the required restructuring, but simply reflect changes in costs or throughput. The pipelines may also seek rate increases due to implementation of this rule in a NGA section 4 filing. However, whether filed to reflect changes due to restructured rate design or other things, such notices of rate changes should be filed separately from the restructuring filings, and will be assigned different docket numbers, because the effective dates of rate changes filed under section 4 will not necessarily coincide with the effective dates of the restructuring filings.[300] Pipelines will not be permitted to implement contested features of their restructuring proposals prematurely by incorporating them in a separate section 4 filing.

The pipelines should propose effective dates for their restructuring that will provide for full compliance sufficiently in advance of the 1993–1994 heating season, as discussed above. Many commenters have suggested that unbundling should not be implemented just prior to or during peak-load season. As discussed previously, the Commission concurs. Because the effective date of full implementation will not occur until the Commission accepts the tariff sheets in the compliance filing, the Commission will ensure that no pipeline has to implement the rule during a peak-load season.[301] The Commission strongly believes that all of the pipelines affected by this rule will be able to implement the full requirements of this rule for the 1993–1994 winter heating season. Thus, most pipelines should be fully unbundled in compliance with this rule by the spring or summer of 1993. In any event, the effective dates for each plan will be subject to Commission approval on a case-by-case basis, in view of the degree of support by interested parties and conformity to the goals and requirements of this rule. However, the Commission will not tolerate delays that would prevent implementation for the 1993–1994 heating season.

The compliance filings must address each and every feature of the restructuring required by this final rule and include a detailed explanation of how the pipeline intends to implement those features. They must include tariff provisions to implement all of the elements in new § 284.14, including unbundled sales, storage, and transportation service on an open access, nondiscriminatory basis, to achieve full equality of service, and to allocate capacity rights on the pipeline's facilities and on upstream pipelines to the pipeline's firm customers.[302] There must be tariff provisions specifying the operational conditions necessary to provide no-notice transportation service, maintain adequate pressure and reliable service at all times, and specifying procedures for operating under curtailment of gas supply or capacity. These filings must also include tariff provisions to implement a capacity release program in conformity to the requirements of this final rule.

The *pro forma* rates must reflect the currently approved cost of service and incorporate the straight fixed variable method of rate design unless the Commission approves otherwise. As discussed in section VIII, *supra*, the filing must include a comparison of the revenue responsibility of each of the pipeline's historic customer classes under SFV and the pipeline's last approved cost classification method. If the revenue responsibility of any class increase 10 percent or more, the pipeline must also include a phase-in plan for implementation. The filing must include detailed explanations of the reasons for each of the pipeline's proposed rates, tariff provisions, and operational provisions, and must include the pipeline's estimate of the costs it expects to incur as a result of complying with this final rule, and any mechanisms proposed to recover those costs. Additionally, pursuant to the Notice of Proposed Policy Statement on Incentive Regulation (Docket No. PL92–1–000), issued March 13, 1992,[303] the Commission is receiving public comment on incentive ratemaking. In issuing the notice of proposed policy statement, the Commission recognized that the pipelines may want to utilize incentive ratemaking proposals as a competitive tool in the restructuring proceedings. Subject to the Commission's actions in the final policy statement on incentive regulation,[304] the pipelines may wish to file an incentive rate proposal along with its restructuring compliance filing. Any such incentive ratemaking proposal filed contemporaneously with the restructuring compliance filing should include sufficient detail to demonstrate the effect of the incentive rates on the straight fixed-variable (SFV) and unbundling objectives discussed above. Additionally, any incentive rate proposal must have the full support of the parties to the restructuring proceedings and be consistent with the Commission's final policy statement.

Some of the commenters assert that it may take some pipelines as much as two years to work out the operational details necessary to ensure reliable and efficient operation in an unbundled environment, without costly new facilities. The Commission disagrees and will not tolerate any unnecessary delay in compliance with this order. Pipelines will bear a heavy burden of persuasion for any request for additional time to postpone full implementation beyond what is necessary for implementation for the 1993–1994 winter heating season. In no event will the Commission permit pipelines to begin charging market-based rates for gas, to make unconstrained ISS sales, or to recover 100 percent of their transition costs, before the Commission determines (by acceptance of the compliance tariff sheets) that they have complied fully with this rule.

The Commission will issue orders on the restructuring filing, and establish further procedures if necessary in view of protests or other comments on the pipeline's filing. The Commission hopes that pipelines and interested parties will

[299] See *ANR Pipeline Co.* v. *FERC*, 863 F.2d 959 (D.C. Cir. 1988) (Commission can permit rate increases as part of compliance filing to implement Commission directed modifications under section 5(a) of the NGA.).

[300] Also, as discussed above, the final Policy Statement on Incentive Ratemaking will address the relationship, if any, between the final rule in these dockets and the filing of any incentive ratemaking proposals for non-competititve pipeline services.

[301] However nothing here precludes early implementation if the pipeline and the parties agree otherwise.

[302] Pipelines with storage facilities must provide detailed explanation and support for their proposed allocation of storage capacity among services.

[303] Incentive Ratemaking for Interstate Natural Gas Pipelines, Oil Pipelines, and Electric Utilities, Notice of Proposed Policy Statement on Incentive Regulation, 58 FERC ¶ 61,287 (1992).

[304] The Commission expects to issue a final policy statement on Incentive Ratemaking of Interstate Natural Gas Pipelines, Oil Pipelines, and Electric Utilities as soon as possible after the close of the period for public comment on April 27, 1992.

achieve a consensus on most features of the restructuring filing before it is filed. If the filing enjoys substantial support, no substantial opposition, and is in compliance with the requirements of this final rule, the Commission will permit the pipeline's proposal to be implemented on a prospective basis in short order.

The Commission will use procedures designed to achieve the most expeditious resolution of any contested issues raised with respect to the restructuring filings. If elements of the compliance filing are in patent conflict with the requirements of this final rule, or other applicable law or policy, the Commission may make summary dispositions on the merits. If review of a pipeline's compliance filing indicates that a pipeline will not achieve full compliance with this rule on a timely basis, the Commission may issue an interim compliance order, to provide direction to the pipeline on the steps necessary to correct deficiencies in its proposal soon enough to avoid delay in implementation of this rule. If there is substantial opposition to the pipeline's plan, but indications that further settlement discussions may resolve the points in dispute expeditiously, the Commission may direct the staff to convene settlement conferences and establish a deadline for submission of a report on the status of the settlement discussions. In proceedings where there are disputed issues that require development of a record, but not necessarily by means of a trial-type hearing, the Commission may use expedited "paper hearing" procedures. The Commission does not intend to require development of a record in a trial-type hearing; therefore the restructuring proceedings will not be set for hearing before administrative law judges unless they are consolidated with other proceedings already pending before a judge.

In several recent cases, the Commission has reviewed "Contesting party provisions" in settlement proposals that appeared to coerce parties into waiving their statutory rehearing and appeal rights by denying them certain services if they seek rehearing or judicial review of an order accepting the settlement.[305] These cases raise the specter that pipelines in restructuring proceedings under the final rule will seek to incorporate such provisions into unilateral settlement offers. The Commission is encouraging the development of settlements to implement this rule. However, as a matter of public policy, the Commission will not tolerate coercive provisions included in a pipeline's offer of settlement that have the effect of forcing parties to acquiesce in a settlement, or parts of a settlement, by threatening the denial of essential services.[306] Thus, a pipeline cannot deny access to its open access storage services, unbundled firm and interruptible transportation services, no-notice delivery service, or capacity release program to a party that contests some provision of its settlement proposal in a restructuring proceeding. The Commission will resolve the issues in contested settlements on the merits, and avoid any question of contesting parties being denied essential services while litigating the contested issues.

To a large extent, the date by which each pipeline fully implements the restructuring required by this rule will depend on the diligence and good faith of the pipeline and interested parties. The Commission has established deadlines for filings and has provided direction for making those filings. The Commission will continue to provide direction and guidance for fully implementing the policies reflected by the requirements of this rule. The Commission respects the rights of pipelines and interested parties to differ over how these policies should best be implemented on a particular pipeline system. However, the Commission will not abide recalcitrance in the restructuring proceedings. If the pipeline's filings are not in compliance with the requirements of this rule, and the pipeline and interested parties cannot resolve differences over what is required to bring the pipeline into full compliance, the Commission will resolve the disputes on the merits. And once the Commission has determined how this rule must be implemented on a particular pipeline system, it will bring the full panoply of its enforcement resources to bear to ensure compliance with its decision.

3. Other Matters

A number of pipelines have urged the Commission to exempt them from the final rule because, they allege, their unique circumstances make applicability of the rule inappropriate. Northern Border Pipeline Company, Overthrust Pipeline Company, Ozark Gas Transmission System, Trailblazer Pipeline Company, and Wyoming Interstate Company argue that the Commission must recognize their unique status as project-financed pipelines and allow flexibility with regard to compliance with the rule. These pipelines state that the provisions regarding capacity reallocation may create problems for them because their lenders have relied on the credit standing of their firm transportation customers as collateral. They assert that assigning capacity to other shippers may necessitate restructuring of their credit agreements or may put them in default. Northern Border also argues that it should be allowed to continue to use its cost-of-service rate design because it is similar in concept to SFV and is appropriate for a transportation only pipeline. Several of these pipelines cite *Ozark Gas Transmission System* v. *FERC*,[307] as holding that the Commission cannot approve a project-financed pipeline, and then later impose conditions that jeopardize its financing.

The capacity releasing program adopted by the final rule will not jeopardize the financing arrangements of these pipelines. As explained above, unless the pipeline otherwise agrees, the firm transportation customer releasing capacity will remain liable on its contract with the pipeline but will receive a credit against its bill on the capacity resold. Thus, the customers whose credit standing has been relied upon by the lenders remain the same. The appropriate rate design for project financed pipelines may be addressed in the individual restructuring proceedings.

Freeport Interstate Pipeline, Pacific Interstate Offshore Co., Pacific Offshore Pipeline Co., and Superior Offshore Pipeline Company and Texas Sea Rim Pipeline, Inc. argue that compliance with the rule is not necessary or appropriate for them because they are small, special purpose, Outer Continental Shelf (OCS) pipelines, generally serving only one customer. Similarly, Alabama-Tennessee Natural Gas Company and Gas Transport, Inc. argue that they should be exempt from the final rule because they are small, non-major pipelines. Gas Transport asserts that administrative costs and burdens will be disproportionately large for small pipelines.

The non-major and OCS pipelines may be required to make few, if any, changes to bring their operations into compliance with the rule, particularly if they provide transportation service only. However, the Commission will not adopt a general exemption for all OCS and non-major pipelines. Instead, the Commission will direct these pipelines to file in a restructuring proceeding and the Commission will address the

[305] See Tennessee Gas Pipeline Co., 57 FERC ¶ 61,360 (1991); and CNG Transmission Corp. 55 FERC ¶ 61,189 (1991).

[306] See CNG Transmission Corp., 55 FERC at p. 61,843.

[307] 897 F.2d 548 (D.C. Cir. 1990).

appropriate requirements for each pipeline in those proceedings.

Great Lakes Transmission Limited Partnership states that the release of upstream capacity is impossible for pipelines transporting Canadian gas from the International Boundary. Great Lakes asserts that much of this gas is subject to regulation by both Canadian and U.S. authorities and that some of the provisions of the rule may be inconsistent with Canadian gas regulation. Great Lakes argues that the rule must be amended to recognize that independent multi-national transportation agreements exist which are subject to international regulation.

Section 284.282 of the final rule provides that downstream pipelines must allocate their capacity on upstream pipelines to firm customers, if the upstream pipeline provides transportation under subpart B or G of part 284 of the Commission's regulations.

Any problems that arise in the implementation of this rule because of the character or nature of certain pipeline transactions will be addressed on a case-by-case basis in the restructuring proceedings.

XII. Environmental Analysis

The Commission concludes that the final rule does not represent a major federal action having a significant adverse impact on the human environment under the Commission's regulations implementing the National Environmental Policy Act.[308] The final rule falls within the categorical exemption provided in the Commission's regulations for the review of rates for the transportation and sale of natural gas under sections 4 and 5 of the NGA [309] and for the sale, exchange, and transportation of natural gas under sections 4, 5, and 7 of the NGA [310] that require no construction of facilities. If construction is proposed in the future, it will be evaluated in individual proceedings. Consequently, neither an environmental assessment or an environmental impact statement is required.

In comments on the NOPR, the Panhandle Customer Group objects to this finding because, they allege, the rule effectively requires LDCs to construct storage and transmission facilities and would encourage producers and marketers to construct new gathering facilities. The Panhandle Customer Group argues that the Commission must consider alternatives to the proposed rule that would result in less construction activity.

The assertions of the Panhandle Customers are entirely unsubstantiated. Nothing in the rule directs or authorizes construction of any facilities. Impacts of future construction will be evaluated by the Commission or by the appropriate environmental authority if a specific proposal is presented.

XIII. Regulatory Flexibility Certification

The Regulatory Flexibility Act (RFA) [311] generally requires a description and analysis of rules that will have a significant economic impact on a substantial number of small entities. Pursuant to section 605(b) of the RFA, the Commission certifies that the final rule will not have a significant impact on a substantial number of small entities.

In comments on the NOPR, the Panhandle Customer Group objects to this finding, alleging that the rule will have a severe economic impact on small LDCs that serve largely residential loads. They assert that elimination of unscheduled delivery service will require expenditures for electronic metering and computing equipment, and that adoption of the SFV rate design and the capacity releasing program will have an economic impact.

Again, these allegations are unsubstantiated.[312] The Commission has explained above why the rule will not have an adverse economic impact on any LDC, large or small.

XIV. Information Collection

The Office of Management and Budget's (OMB) regulations require that OMB approve certain information collection requirements imposed by agency rules.[313]

In the NOPR, the Commission estimated the public reporting burden for the collection of information in the proposed rule to average 4,810 hours per response under FERC–544, Gas Pipeline Rates: Rate Change (Formal) (1902–0153). The total reporting burden associated with the proposed rule was estimated to be 408,850 hours. The estimate included time for reviewing the requirements adopted in the rule, searching existing data sources, gathering and maintaining the data needed, completing and reviewing the collection of information and filing this information with the Commission. In the NOPR, the Commission stated that interested persons could file comments regarding this burden or other aspects of this collection of information, including suggestions reducing this burden, to the Commission. No comments were received on the public reporting burden. The final rule establishes certain requirememts and information collections that differ slightly from the NOPR.

The information collection forms affected by the final rule are: FERC–545, Gas Pipeline Rates: Rate Change (Non-formal), (1902–0154); FERC–549, Gas Pipeline Rates: NGPA Title III Transactions; Ceiling Prices; Old Gas Pricing Structure, (1902–0086); and FERC–592, Marketing Affiliates of Interstate Pipelines (1902–0157). These information collections are required in order for the Commission to carry out its legislative mandate under the NGA and the NGPA. The information required by the final rule will allow the Commission to ensure that firm transportation service provided under part 284 of the Commission's regulations for nonpipeline sellers is equal to transportation service associated with a pipeline's firm sales service.

An estimated 89 respondents will be affected by this rule. The respondents will consist of pipeline companies subject to the Commission's jurisdiction that peform self-implementing transportation under either the NGA or the NGPA. The Commission finds that: (a) the public reporting burden will average 4,810 hours per response under FERC–545, 2.7 hours per response under FERC–549, and 9.94 hours per response under FERC–592. The annual reporting burden will be 428,090 hours for FERC–545, 410 hours for FERC–549, and 885.2 hours for FERC–592, for a total estimated burden of 429,385.2 hours; (b) the frequency of response under FERC–545 will be a one-time filing by respondents; (c) for the other data collections the number of annual responses will vary. The Commission anticipates that the public reporting burden will decrease substantially after the one-time implementation filings have been made.

XV. Effective Date

This Final Rule is effective May 18, 1992.

List of Subjects in 18 CFR Part 284

Continental shelf, Natural gas, Reporting and recordkeeping requirements.

In consideration of the foregoing, the Commission amends part 284, chapter I, title 18, Code of Federal Regulations, as set forth below.

[308] 18 CFR part 380.

[309] 18 CFR 380.4(a)(25).

[310] 18 CFR 380.4(a)(27).

[311] 5 U.S.C. 601–612 (1988).

[312] In any event, the rule does not eliminate no-notice service.

[313] 5 CFR part 1320.

By the Commission. Commissioner Langdon concurred in part and dissented in part with a separate statement attached. Commissioner Terzic concurred with a separate statement to be issued later.

Lois D. Cashell,

Secretary.

PART 284—CERTAIN SALES AND TRANSPORTATION OF NATURAL GAS UNDER THE NATURAL GAS POLICY ACT OF 1978 AND RELATED AUTHORITIES

1. The authority citation for part 284 continues to read as follows:

Authority: 15 U.S.C. 717–717w; 15 U.S.C. 3301–3432; 43 U.S.C. 1331–1356; 42 U.S.C. 7101–7352; E.O. 12009, 3 CFR, 1978 Comp., p. 142.

2. In § 284.1, paragraph (a) is revised and a new paragraph (c) is added to read as follows:

§ 284.1 Definitions.

(a) *Transportation* includes storage, exchange, backhaul, displacement, or other methods of transportation.

* * * * *

(c) *Market center* means an area where gas purchases and sales occur at the intersection of different pipelines.

3. In § 284.8, paragraph (a)(1) is revised, new paragraph (a)(4) is added, paragraph (b) is amended by adding paragraph (b)(1) designation after the heading, "*Non-discriminatory access.*" and before the words "An interstate pipeline", paragraphs (b)(2) through (b)(5) are added, and paragraph (d) is revised to read as follows:

§ 284.8 Firm transportation service.

(a) *Firm transportation availability.* (1) An interstate pipeline that provides transportation service under subpart B or G or this part must offer such transportation service on a firm basis and separately from any sales service.

* * * * *

(4) An interstate pipeline that provided a firm sales service on May 18, 1992, and that offers transportation service on a firm basis under subpart B or G of this part, must offer a firm transportation service under which firm shippers may receive delivery up to their firm entitlements on a daily basis without penalty.

(b) *Non-discriminatory access.* * * *

(2) An interstate pipeline that offers transportation service on a firm basis under subpart B or G of this part must provide each service on a basis that is equal in quality for all gas supplies transported under that service, whether purchased from the pipeline or another seller.

(3) An interstate pipeline that offers transportation service on a firm basis under subpart B or G of this part must provide all shippers with equal and timely access to information relevant to the availability of such service, including, but not limited to, the availability of capacity at receipt points, on the mainline, at delivery points, and in storage fields, and whether the capacity is available directly from the pipeline or through capacity release.

(4) The requirement of paragraph (b)(3) of this section must be implemented through the use of an Electronic Bulletin Board on which the pipeline must provide for:

(i) Downloading by users,

(ii) Daily back-up of information displayed on the board, which must be available for user review for at least three years,

(iii) Purging information on completed transactions from current files,

(iv) Display of most recent entries ahead of information posted earlier, and

(v) On-line help, a search function that permits users to locate all information concerning a specific transaction, and a menu that permits users to separately access notices of available capacity, each record in the transportation log, and standards of conduct information.

(5) An interstate pipeline that offers transportation service on a firm basis under subpart B or G of this part may not include in its tariff any provision that inhibits the development of market centers.

* * * * *

(d) *Reservation fee.* Where the customer purchases firm service, a pipeline may impose a reservation fee or charge on a shipper as a condition for providing such service. Except for pipelines subject to subpart C of this part, if a reservation fee is charged, it must recover all fixed costs attributable to the firm transportation service, unless the Commission permits the pipeline to recover some of the fixed costs in the volumetric portion of a two-part rate. A reservation fee may not recover any variable costs or fixed costs not attributable to the firm transportation service. Except as provided in this paragraph, the pipeline may not include in a rate for any transportation provided under subpart B, C or G of this part any minimum bill or minimum take provision, or any other provision that has the effect of guaranteeing revenue.

* * * * *

4. In § 284.9, paragraph (a)(1) is revised, paragraph (b) is amended by adding paragraph (b)(1) designation after the heading, *"Non-discriminatory access."* and before the words "An interstate or intrastate pipeline", and new paragraphs (b)(2) through (b)(5) are added to read as follows:

§ 284.9 Interruptible transportation service.

(a) *Interruptible transportation availability.* (1) An interstate pipeline that provides firm transportation service under subpart B or G of this part must also offer transportation service on an interruptible basis under that subpart or subparts and separately from any sales service.

* * * *

(b) *Non-discriminatory access.* * * *

(2) An interstate pipeline that offers transportation service on an interruptible basis under subpart B or G of this part must provide each service on a basis that is equal in quality for all gas supplies transported under that service, whether purchased from the pipeline or another seller.

(3) An interstate pipeline that offers transportation service on an interruptible basis under subpart B or G of this part must provide all shippers with equal and timely access to information relevant to the availability of such service.

(4) The requirement of paragraph (b)(3) of this section must be implemented through the use of an Electronic Bulletin Board with the features required under § 284.8(b)(4).

(5) An interstate pipeline that offers transportation service on an interruptible basis under subpart B or G of this part may not include in its tariff any provision that inhibits the development of market centers.

* * * * *

5. Section 284.12 is amended by removing the words "May 1" and adding, in their place, the words "March 1", and by inserting the phrase ", and the estimated storage capacity and maximum daily delivery capability of storage facilities," after "pipeline's system" and before "under".

6. Section 284.14 is added to read as follows:

§ 284.14 Provisions governing pipeline restructuring.

(a) *Applicability.* This section applies to any interstate natural gas pipeline that offers transportation service under subpart B or G of this part on May 18, 1992.

(b) *Compliance filing.* (1) The pipelines subject to this section must make a compliance filing on or before the dates set forth in paragraph (b)(4) of this section to implement the provisions of § 284.1(a), § 284.8(a)(1), (a)(4), (b)(2)–(5), and (d), § 284.9(a)(1) and (b)(2)–(5),

§ 284.221(d), and subparts H and J of this part, including, but not limited to, tariff provisions to implement without undue discrimination:

(i) Unbundled sales and transportation services,

(ii) Open access storage service,

(iii) Reasonable and non-discriminatory terms and conditions for operating unbundled open-access transportation,

(iv) Equality of transportation service for all gas transported under each rate schedule,

(v) Allocation of aggregate receipt point capacity, individual receipt point capacity, mainline segment capacity, storage capacity, and delivery point capacity,

(vi) Shipper flexibility in changing receipt and delivery points,

(vii) Scheduling of gas injections into the mainline and into storage, scheduling of gas deliveries from storage and from the mainline, the setting and charging of penalties, balancing rights, and the instantaneous receipt and delivery of gas,

(viii) No-notice transportation service, with separately identified cost components,

(ix) Equality of access to information on availability of service,

(x) Non-discriminatory plans for operating under curtailment of capacity and gas supply (if the pipeline sells gas),

(xi) Rate design and cost allocation changes,

(xii) A capacity release mechanism,

(xiii) Right-of-first-refusal procedures for use upon the expiration of long-term, firm transportation contracts, and

(xiv) Assignment of capacity rights on upstream pipelines to firm customers.

(2) The compliance filing must be filed no later than the date specified for each pipeline in paragraph (b)(4) of this section in the restructuring proceeding instituted by the Commission for the implementation of the provisions listed in paragraph (b)(1) of this section.

(3)(i) The changes in rates, charges, classifications, or services, or in any rule, regulation, or service agreement, necessary to comply with this paragraph must be filed as *pro forma* tariff sheets, for illustrative purposes only, with rates that are designed to recover the same revenue requirement as the pipeline's rates in effect on the date the compliance filing is made.

(ii) The compliance filing must also include a comparison of the revenue responsibility of each of the pipeline's historical customer classes for the unbundled services under

(A) the pipeline's last approved cost classification method for cost allocation and rate design, and

(B) the straight fixed-variable (SFV) cost classification method for cost allocation and rate design. Under the straight fixed-variable method all fixed costs are classified to the demand component. If the comparison shows that adopting SFV for cost allocation and rate design will result in a 10 percent or greater increase in revenue responsibility for any customer class, the compliance filing must include a plan for phasing-in the cost shift due to SFV over no more than a four year period.

(iii) The compliance filing must also include an estimate of the costs of implementing the provisions of this paragraph and any mechanisms proposed for recovering those costs.

(4) The following pipelines must file on or before October 1, 1992:

ANR Pipeline Company
ANR Storage Company
Arkla Energy Resources
Colorado Interstate Gas Company
Columbia Gas Transmission Corporation
Columbia Gulf Transmission Corporation
Michigan Gas Storage
Northern Natural Gas Company
Questar Pipeline Company
Southern Natural Gas Company
Texas Eastern Transmission Corporation
Williams Natural Gas Company
Williston Basin Interstate Pipeline

The following pipelines must file on or before November 2, 1992:

CNG Transmission Corporation
Equitrans, Inc.
Florida Gas Transmission Company
Iroquois Gas Transmission
Kentucky-West Virginia Gas Company
KN Energy, Inc.
Mid Louisiana Gas Company
National Fuel Gas Supply Corporation
Panhandle Eastern Pipe Line Company
Tennessee Gas Pipeline Company
Texas Gas Transmission Corporation
Trunkline Gas Company
United Gas Pipe Line Company

The following pipelines must file on or before December 1, 1992:

Alabama Tennessee Natural Gas Company
Algonquin Gas Transmission Company
Altamont Gas Transmission Company
Carnegie Natural Gas Company
Cornerstone Pipeline Company
Delta Pipeline Company
East Tennessee Natural Gas Company
Gas Gathering Corporation
Gas Transport Inc.
Gateway Pipeline Company
Green Canyon Pipeline Company
Gulf States Transmission Corporation
Inland Gas Company, Inc.
Louisiana Nevada Transit Company
Midwestern Gas Transmission Company
MIGC, Inc.
Mississippi River Transmission Corporation
Moraine Pipeline Company
Natural Gas Pipeline Company of America
Pacific Gas Transmission Company
Phillips Gas Pipeline Company
Riverside Pipeline Company
South Georgia Natural Gas Company
Valero Interstate Transmission Company
Valley Gas Transmission, Inc.
Viking Gas Transmission Company
Western Gas Interstate Company
Western Transmission Corporation
Wyoming California Pipeline

The following pipelines must file on or before December 31, 1992:

Black Marlin Pipeline Company
Canyon Creek Compression Company
Caprock Pipeline Company
Chandeleur Pipe Line Company
El Paso Natural Gas Company
Freeport Interstate Pipeline Company
Gasdel Pipeline System, Inc.
Great Lakes Gas Transmission
High Island Offshore System
Kern River Gas Transmission Company
Mojave Pipeline Company
Northern Border Pipeline Company
Northern Penn Gas Company
Northwest Pipeline Corporation
OkTex Pipeline Company
Overthrust Pipeline Company
Ozark Gas Transmission System
Pacific Interstate Offshore Company
Pacific Offshore Pipeline Company
Paiute Pipeline Company
Pelican Interstate Gas System
Point Arguello Natural Gas Line Company
Sabine Pipe Line Company
Sea Robin Pipeline Company
Seagull Interstate Corporation
Stingray Pipeline Company
Superior Offshore Pipeline Company
Tarpon Transmission Company
Texas Sea Rim Pipe Line, Inc.
Trailblazer Pipeline Company
Transcontinental Gas Pipe Line Corporation
Transwestern Pipeline Company
U-T Offshore System
West Gas Interstate, Inc.
Wyoming Interstate Company, Ltd.

(c) *Restructuring discussions.* (1) By June 8, 1992, a pipeline subject to this section must initiate restructuring discussions concerning implementation of the provisions of this section with all its customers and other interested parties that intervene in its restructuring proceeding instituted by the Commission for implementation of the provisions listed in paragraph (b)(1) of this section.

(2) By July 7, 1992, a pipeline subject to this section must prepare and serve a summary of its proposed restructuring plan on every intervenor in its restructuring proceeding, addressing each and every element of the compliance filing required under paragraph (b)(1) of this section.

(d) *Adjustments to obligations to purchase gas; automatic abandonment of sales.* (1) Any firm sales customer of a pipeline subject to this section may reduce or terminate its right or obligation to purchase gas under any

contract with that pipeline for the sale of natural gas in effect on May 18, 1992, by giving notice to the pipeline during the pipeline's restructuring proceeding.

(2) A pipeline subject to this section is authorized to abandon the sale of gas to any purchaser to the extent:

(i) The purchaser exercises its right to reduce or terminate its right or obligation to purchase under the provisions of paragraph (d)(1) of this section, or

(ii) The purchaser refuses to pay the rate the pipeline offers for unbundled gas sales. The pipeline must file a report of any such abandonment of sales with the Commission within 30 days of the date of abandonment.

(3) The reduction or termination of service under the contract and the abandonment of sales under paragraph (d)(2) of this section will be effective on the effective date (as approved by the Commission) of the tariff sheets implementing service under the pipeline's blanket certificate for unbundle sales services under § 284.284.

(e) *Adjustments to firm transportation service; automatic abandonment.* (1) Any firm shipper on a pipeline subject to this section must give notice to the pipeline during the pipeline's restructuring proceeding that the shipper wants to retain, reduce, or terminate its contractual rights to firm transportation service.

(2) Except as provided in paragraph (e)(4) of this section, a pipeline subject to this section may abandon firm transportation service under a contract with a firm shipper to the extent the shipper gives the notice to reduce or terminate described in paragraph (e)(1) of this section. The authority to abandon service does not apply unless during the pipeline's restructuring proceeding:

(i) The pipeline executes a contract with another shipper for the transportation rights, or

(ii) The pipeline agrees to the reduction or termination of contractual rights.

(3) The authority to abandon service under this paragraph is effective respectively:

(i) On the effective date of the contract described in paragraph (e)(2) of this section; or

(ii) On the effective date of the pipeline's agreement to the reduction or termination of contractual rights described in paragraph (e)(2).

(4) Paragraph (e)(1) of this section does not apply to the firm transportation service provided for a downstream pipeline subject to subpart B or G of this part on an upstream pipeline subject to subpart B or G of this part.

7. In § 284.106, the introductory text of paragraph (a) is amended by inserting the words "(except storage)" after "transportation" and before "under § 284.102," the introductory text of paragraph (c) is amended by removing the words "May 1" and adding in their place, the words "March 1", and by inserting the words "(except storage)" after "transportation service" and before "provided," and the introductory text of paragraph (d) is amended by inserting the words "(except storage)" after "transportation arrangement" and before "under § 284.102".

8. In § 284.106, a new paragraph (g) is added, to read as follows:

§ 284.106 Reporting requirements.

* * * * *

(g) *Semi-annual storage report.* Within 30 days of the end of each complete storage injection and withdrawal season, the interstate pipeline shall file with the Commission a report of storage activity provided under the authority of § 284.102. The report must be signed under oath by a senior official, consist of an original and give conformed copies, and contain a summary of storage injection and withdrawal activities to include the following:

(1) The identify of each customer injecting gas into storage and/or withdrawing gas from storage, identifying any affiliation with the interstate pipeline;

(2) The rate schedule under which the storage injection or withdrawal service was performed;

(3) The maximum storage quantity and maximum daily withdrawal quantity applicable to each storage customer;

(4) For each storage customer, the volume of gas (in dekatherms) injected into and/or withdrawn from storage during the period;

(5) The unit charge and total revenues received during the injection/withdrawal period from each storage customer, noting the extent of any discounts permitted during the period; and

(6) The related docket numbers in which the interstate pipeline reported storage related injection/withdrawal transportation services.

(9) In § 284.126, the introductory text of paragraph (a) is amended by inserting the words "(except storage)" after "transportation" and before "under this subpart," the introductory text of paragraph (c) is amended by removing the words "May 1" and adding, in their place, the words "March 1", and by inserting the words "(except storage)" after "transportation service" and before "provided," and the introductory text of paragraph (d) is amended by inserting the words "(except storage)" after "transportation arrangement" and before "authorized".

10. In § 284.126, a new paragraph (g) is added, to read as follows:

§ 284.126 Reporting requirements.

* * * * *

(g) *Semi-annual storage report.* Within 30 days of the end of each complete storage injection and withdrawal season, the intrastate pipeline shall file with the Commission a report of storage activity provided under the authority of § 284.122. The report must be signed under oath by a senior official, consist of an original and five conformed copies, and contain a summary of storage injection and withdrawal activities to include the following:

(1) The identity of each customer injecting gas into storage and/or withdrawing gas from storage;

(2) The docket where the storage injection or withdrawal rates were approved;

(3) The maximum storage quantity and maximum daily withdrawal quantity applicable to each storage customer;

(4) For each storage customer, the volume of gas (in dekatherms) injected into and/or withdrawn from storage during the period;

(5) The unit charge and total revenues received during the injection/withdrawal period from each storage customer; and

(6) The related docket numbers in which the intrastate pipeline reported storage related injection/withdrawal transportation services.

11. In § 284.221, paragraph (d) is revised to read as follows:

§ 284.221 General rule; transportation by interstate pipelines on behalf of others.

* * * * *

(d) *Pre-grant of abandonment.* (1) Except as provided in § 284.14(e), and paragraphs (d)(2) and (d)(3) of this section, abandonment of transportation services is authorized pursuant to section 7(b) of the Natural Gas Act upon the expiration of the contractual term or upon termination of each individual transportation arrangement authorized under a certificate granted under this section.

(2) Paragraph (d)(1) of this section does not apply if the individual transportation arrangement is for firm transportation under a contract with a term of more than one year, and the firm shipper:

(i) Exercises any contractual right to continue such service; or

(ii) Gives notice that it wants to continue its transportation arrangement and will match the longest term and highest rate for its firm service, up to the maximum rate under § 284.7, offered to the pipeline during the period established in the pipeline's tariff for receiving such offers by any other person desiring firm capacity, and executes a contract matching those terms.

(3) Paragraph (d)(1) of this section does not apply where, after February 13, 1991, and before May 18, 1992, a shipper converted from sales service to firm transportation service under the provisions of § 284.10 or under a separate agreement (to the extent of conversion of pre-existing sales volumes).

* * * * *

12. In § 284.223, the introductory text of paragraph (d)(1) is amended by inserting the words "(except storage)" after "transportation" and before "authorized," the introductory text of paragraph (d)(3) is amended by removing the words "May 1" and adding, in their place, the words "March 1", and inserting the words "(except storage)" after "transportation service" before "provided," and the introductory text of paragraph (d)(4) is amended by inserting the words "(except storage)" after "transportation arrangement" and before "under this section".

13. In § 284.223, a new paragraph (d)(5) is added, to read as follows:

§ 284.223 Transportation by interstate pipelines on behalf of shippers other than interstate pipelines.

* * * * *

(d) *Reporting requirements.* * * *

(5) *Semi-annual storage reports.* Within 30 days of the end of each complete storage injection and withdrawal season, the interstate pipeline shall file with the Commission a report of storage activity provided under the authority of this section. The report must be signed under oath by a senior official, consist of an original and five conformed copies, and contain a summary of storage injection and withdrawal activities to include the following:

(i) The identity of each customer injecting gas into storage and/or withdrawing gas from storage, identifying any affiliation with the interstate pipeline;

(ii) The rate schedule under which the storage injection or withdrawal service was performed;

(iii) The maximum storage quantity and maximum daily withdrawal quantity applicable to each storage customer;

(iv) For each storage customer, the volume of gas (in dekatherms) injected into and/or withdrawn from storage during the period;

(v) The unit charge and total revenues received during the injection/withdrawal period from each storage customer, noting the extent of any discounts permitted during the period; and

(vi) The related docket numbers in which the interstate pipeline reported storage related injection/withdrawal transportation services.

* * * * *

14. In part 284, a new subpart H is added to read as follows:

Subpart H—Assignment of Capacity on Interstate Pipelines

Sec.
284.241 Applicability.
284.242 Assignment of firm capacity on upstream pipelines.
284.243 Release of firm capacity on interstate pipelines.

Subpart H—Assignment of Capacity on Interstate Pipelines

§ 284.241 Applicability.

This subpart applies to any interstate pipeline that offers transportation service under subpart B or G of this part.

§ 284.242 Assignment of firm capacity on upstream pipelines.

An interstate pipeline that offers transportation service on a firm basis under subpart B or G of this part must offer without undue discrimination to assign to its firm shippers its firm transportation capacity, including contract storage, on upstream pipelines that offer a transportation service under subpart B or G of this part. An upstream pipeline is authorized and required to permit a downstream pipeline to assign its firm capacity to the downstream pipeline's firm shippers.

§ 284.243 Release of firm capacity on interstate pipelines.

(a) An interstate pipeline that offers transportation service on a firm basis under subpart B or G of this part must include in its tariff a mechanism for firm shippers to release firm capacity to the pipeline for resale by the pipeline on a firm basis under this section.

(b) Firm shippers must be permitted to release their capacity, in whole or in part, on a permanent or short-term basis, without restriction on the terms or conditions of the release. A firm shipper may arrange for a replacement shipper to obtain its released capacity from the pipeline. A replacement shipper is any shipper that obtains released capacity.

(c) A firm shipper that wants to release any or all of its firm capacity must notify the pipeline of the terms and conditions under which the shipper will release its capacity. The firm shipper must also notify the pipeline of any replacement shipper designated to obtain the released capacity under the terms and conditions specified by the firm shipper.

(d) The pipeline must provide notice of the release, the terms and conditions, and the name of any replacement shipper designated in paragraph (b) of this section, on an electronic bulletin board, for a reasonable period.

(e) The pipeline must allocate released capacity to the person offering the highest rate (not over the maximum rate) and offering to meet any other terms and conditions of the release. If more than one person offers the highest rate and meets the terms and conditions of the release, the released capacity may be allocated on a basis provided in the pipeline's tariff, provided however, if the replacement shipper designated in paragraph (b) of this section offers the highest rate, the capacity must be allocated to the designated replacement shipper.

(f) Unless otherwise agreed by the pipeline, the contract of the shipper releasing capacity will remain in full force and effect, with the net proceeds from any resale to a replacement shipper credited to the releasing shipper's reservation charge.

(g) To the extent necessary, a firm shipper on an interstate pipeline that offers transportation service on a firm basis under subpart B or G of this part is granted a limited-jurisdiction blanket certificate of public convenience and necessity pursuant to section 7 of the Natural Gas Act solely for the purpose of releasing firm capacity pursuant to this section.

15. In part 284, a new subpart J is added to read as follows:

Subpart J—Blanket Certificates Authorizing Certain Natural Gas Sales by Interstate Pipelines

Sec.
284.281 Applicability.
284.282 Definitions.
284.283 Point of unbundling.
284.284 Blanket certificates for unbundled sales services.
284.285 Pregrant of abandonment of unbundled sales services.
284.286 Standards of conduct for unbundled sales service.
284.287 Implementation and effective date.
284.288 Reporting requirements.

Subpart J—Blanket Certificates Authorizing Certain Natural Gas Sales by Interstate Pipelines

§ 284.281 Applicability.

This subpart applies to any interstate pipeline that offers transportation service under subpart B or G of this part.

§ 284.282 Definitions.

(a) *Bundled sales service* is gas sales service that is not sold separately from transportation service.

(b) *Sales service* includes firm or interruptible gas sales.

(c) *Unbundled sales service* is gas sales service that is sold separately from transportation service.

§ 284.283 Point of unbundling.

A sales service is unbundled when gas is sold at a point before it enters a mainline system, at an entry point to a mainline system from a production area, or at an intersection with another pipeline system.

§ 284.284 Blanket certificates for unbundled sales services.

(a) *Authorization.* An interstate pipeline that offers transportation service under subpart B or G of this part is granted a blanket certificate of public convenience and necessity pursuant to section 7 of the Natural Gas Act authorizing it to provide unbundled firm or interruptible sales in accordance with the provisions of this section.

(b) *Conversion to unbundled firm sales service and firm transportation service.* On the effective date of the pipeline's blanket certificate for unbundled sales services under paragraph (a) of this section, firm sales entitlements under any firm sales service agreement for a bundled sales service are converted to an equivalent amount of unbundled firm sales service and an equivalent amount of unbundled firm transportation service, except as adjusted in §§ 284.14 (d) and (e).

(c) *Conversion to unbundled interruptible sales service and interruptible transportation service.* On the effective date of the pipeline's blanket certificate for unbundled sales services under paragraph (a) of this section, interruptible sales volumes under any interruptible sales service agreement for a bundled sales service are converted to an equivalent amount of unbundled sales service and an equivalent amount of unbundled interruptible transportation service.

(d) A pipeline that provides unbundled sales service under this section may serve as an agent of the sales customer to arrange for any pipeline-provided service necessary to deliver gas to the customer.

§ 284.285 Pregrant of abandonment of unbundled sales services.

Abandonment of unbundled sales services is authorized pursuant to section 7(b) of the Natural Gas Act upon the expiration of the contractual term or upon termination of each individual sales arrangement authorized under § 284.284.

§ 284.286 Standards of conduct for unbundled sales service.

(a) To the maximum extent practicable, the pipeline must organize its unbundled sales and transportation operating employees so that they function independently of each other.

(b) The pipeline must conduct its business to conform to the requirements set forth in § 284.8(b)(2) and § 284.9(b)(2) with respect to the equality of service by not giving shippers of gas sold by the pipeline any preference over shippers of gas sold by any other merchant in matters relating to part 284 transportation.

(c) The pipeline must comply with § 161.3 (a), (b), (d) and (l) of this chapter and comply with § 161.3 (c), (e), (f), (g), (h), and (i) of this chapter by considering its unbundled sales operating employees as an operational unit which is the functional equivalent of a marketing affiliate.

(d) The pipeline must comply with § 250.16 of this chapter by considering its unbundled sales operating employees as an operational unit which is the functional equivalent of a marketing affiliate.

(e) A pipeline that provides unbundled sales service under § 284.284 must file tariff provisions and procedures as part of its compliance filing under § 284.14 indicating how the pipeline is complying with the standards of this section.

§ 284.287 Implementation and effective date.

(a) Except as provided in paragraph (b) of this section, a pipeline that offers transportation under subpart B or G of this part must file revised tariff sheets to implement the requirements of this subpart J as part of the compliance filing required under § 284.14.

(b) A pipeline that offers transportation under subpart B or G of this part that is not authorized to make sales for resale as of the date of its required filing under § 284.14 need not file to implement this subpart J with its filing under § 284.14, but prior to offering any sales service, such a pipeline must file revised tariff sheets to implement this subpart J.

(c) A blanket certificate issued under § 284.284 will be effective on the effective date (as approved by the Commission) of the tariff sheets implementing service under that certificate. For a pipeline that is required to file under § 284.14, the tariff sheets implementing service under the blanket certificate will not be effective until after Commission approval of the compliance filings required by § 284.14(b).

§ 284.288 Reporting requirements.

Interstate pipelines engaging in sales under a certificate granted under § 284.284 must file with the Commission by March 1 of each year, an annual report for the preceding calendar year describing for each transaction the identities of the parties, the type of service provided (firm or interruptible), the total volumes sold, and the total revenues received. The report must be signed under oath by a senior official of the company.

Note: This appendix will not appear in the Code of Federal Regulations. Appendix: Separate Opinion of Commissioner Langdon.

Jerry J. Langdon, Commissioner, *concurring in part and dissenting in part:*

This Order represents a watershed for the natural gas industry. It marks a turning point for parties to permanently leave outmoded and failed governmental policies behind to face a largely market-driven regulatory regime. Those who fail to take advantage of this opportunity to craft market-sensitive solutions to their energy needs will undoubtedly be left behind. This Order provides a road map to guide all parties toward a competitive market for natural gas without mandating which route they should choose.

I fully support this Order as a final major move toward realizing the promises first set forth in Order No. 436. In the past few years, the Commission has been criticized for its piecemeal approach to implementing important policy objectives. This piecemeal approach has unnecessarily prolonged the transition of the industry by limiting or obviating competitive choices by individual segments of the industry. By dealing globally with a number of inter-related issues, the Commission will allow market forces—and not regulators—to begin to drive the natural gas industry.

I only regret that we did not take two more steps to facilitate the process:

- Provide an additional mechanism to shorten the transition cost recovery process to allow true market signals to emerge sooner rather than later, and
- Devise an alternative cost recovery mechanism for the non-market sensitive Great Plains gas.

As to the former I concur; as to the latter, I dissent as discussed below.

Order No. 636 provides only two mechanisms which act to limit gas supply realignment costs which may result from

restructuring negotiations: eligibility and prudence. I take seriously the Order No. 636 process for both mechanisms in light of the billions of dollars that have already been billed to consumers in take-or-pay costs.

The Commission's past record on prudence review has been impotent at best. But, as a result of the full pass-through of transition costs allowed by this rule, the Commission has a new, larger prudence role to play. First, we must ensure that transition costs recovered pursuant to Order No. 636 are closely limited to contract realignments occurring as a direct result of implementing this rule. Second, we must determine that the remaining supply contracts are the product of prudent market-driven transactions.

In discussions leading up to the Final Order, I strongly favored an additional, *optional* mechanism which would have encouraged pipelines to offer 10 percent absorption of gas supply realignment costs in exchange for their customers' forgoing their rights to challenge prudence. I believe this optional approach is reasonable, and moreover, is not precluded by the rule. I expect that the pipelines and parties may well use this mechanism as an alternative to lengthy, costly and uncertain prudence reviews.

As to the Order No. 636 treatment of Great Plains gas, every comma, word, sentence and paragraph of the Order is internally inconsistent. Order No. 636's sweeping changes are driven by the overriding need to make natural gas a competitive commodity. We do this by eliminating cross-subsidies and by billing away costs associated with the old way of doing business. Yet in Great Plains, we are timid. I fail to see how the pass-through of such extraordinary gas costs will ultimately benefit the consumer, or transmit accurate pricing signals.

I understand the public trust responsibility with respect to recoupment of the public investment in Great Plains and I would support a proposal to retire that investment through a surcharge on natural gas transportation. The continued operational feasibility of Great Plains, however, should be a choice consumers should make by their willingness to pay the cost of converting coal to gas.

In all other regards, I enthusiastically support the Order. I expect that it will significantly contribute to improving the health and efficiencies of the natural gas industry to the benefit of the nation's consumers.

Jerry J. Langdon,

Commissioner.

[FR Doc. 92-8526 Filed 4-15-92; 8:45 am]

BILLING CODE 6717-01-M

DEPARTMENT OF JUSTICE

28 CFR Part 14

[AG Order No. 1583-92]

Administrative Claims Under the Federal Tort Claims Act; Delegation of Authority

AGENCY: Department of Justice.

ACTION: Final rule.

SUMMARY: This Order delegates authority to the Secretary of Transportation to settle administrative claims presented pursuant to the Federal Tort Claims Act where the amount of the settlement does not exceed $100,000. The Order implements Public Law 101-552. This Order will alert the general public to the Secretary of Transportation's new authority, and is being codified in the CFR to provide a permanent record of this delegation.

EFFECTIVE DATE: April 16, 1992.

FOR FURTHER INFORMATION CONTACT: Jeffrey Axelrad, Director, Torts Branch, Civil Division, U.S. Department of Justice, Washington, DC 20530, (202) 501-7075.

SUPPLEMENTARY INFORMATION: This Order has been issued to delegate settlement authority and is a matter solely related to division of responsibility between the Department of Justice and the United States Department of Transportation. It does not have a significant economic impact on a substantial number of small entities. 5 U.S.C. 605(b). It is not a major rule within the meaning of Executive Order No. 12291.

List of Subjects in 28 CFR Part 14

Authority delegations (government agencies), Claims.

By virtue of the authority vested in me, including 28 U.S.C. 509, 510, 5 U.S.C. 301, and 38 U.S.C. 223(a), title 28 of the Code of Federal Regulations is amended as follows:

PART 14—ADMINISTRATIVE CLAIMS UNDER FEDERAL TORT CLAIMS ACT

1. The authority citation for part 14 continues to read as follows:

Authority: 5 U.S.C. 301; 28 U.S.C. 509, 510, 2672; 38 U.S.C. 223(a).

APPENDIX TO PART 14—[AMENDED]

2. Part 14 is amended by adding a new provision at the end of the appendix to part 14 to read as follows:

Delegation of Authority to the Secretary of Transportation

Section 1. Authority to compromise tort claims.

(a) The Secretary of Transportation shall have the authority to adjust, determine, compromise and settle a claim involving the United States Department of Transportation under section 2672 of title 28, United States Code, relating to the administrative settlement of federal tort claims, if the amount of the proposed adjustment, compromise, or award does not exceed $100,000. When the Secretary of Transportation believes a claim pending before him presents a novel question of law or of policy, he shall obtain the advice of the Assistant Attorney General in charge of the Civil Division.

(b) The Secretary of Transportation may redelegate in writing the settlement authority delegated to him under this section.

Section 2. Memorandum.

Whenever the Secretary of Transportation settles any administrative claim pursuant to the authority granted by section 1 for an amount in excess of $50,000 and within the amount delegated to him under section 1, a memorandum fully explaining the basis for the action taken shall be executed. A copy of this memorandum shall be sent to the Director, FTCA Staff, Torts Branch of the Civil Division.

Dated: April 8, 1992.

William P. Barr,

Attorney General.

[FR Doc. 92-8787 Filed 4-15-92; 8:45 am]

BILLING CODE 4410-01-M

DEPARTMENT OF THE INTERIOR

Minerals Management Service

30 CFR Parts 202, 206, and 207

Oil and Gas Product Valuation Regulations

April 7, 1992.

AGENCY: Minerals Management Service (MMS), Interior.

ACTION: Notice of training seminars.

SUMMARY: The Minerals Management Service (MMS) hereby gives notice that it will conduct training seminars at the locations and dates given below highlighting changes affecting the revised oil and gas product valuation regulations that were published in the **Federal Register** on January 15, 1988, (53 FR 1184 and 1230) and became effective March 1, 1988. The seminars will focus on the methods of determining value of oil and gas production for royalty purposes with emphasis on recent amendments to the product valuation regulations. Specific topics suggested by interested parties will also be considered.

DATES: See Supplementary Information

ADDRESSES: See Supplementary Information.

FOR FURTHER INFORMATION CONTACT: Mr. Richard Adamski, Oil and Gas Valuation Branch (OGVB), Royalty Valuation and Standards Division (RVSD), (303) 231-3404 or (FTS) 326-3404 or Mr. Scott Ellis, OGVB, RVSD, (303) 231-3543 or (FTS) 326-3543.