FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, D.C. 20426

April 9, 2004

In Reply Refer To:
ANR Pipeline Company
Docket No. RP99-301-108

ANR Pipeline Company
Nine Greenway Plaza
Houston, Texas 77046

Attention: Christopher D. Young
Senior Counsel

Reference: Negotiated Rate Agreement and Related Contract Nos. 110257, 110258, and 110259

Ladies and Gentlemen:

1. On March 12, 2004, ANR Pipeline Company (ANR) filed a negotiated rate agreement between ANR and NJR Energy Services Company (NJRES) together with a related storage contract (No. 110257) under Rate Schedule FSS, and two related firm transportation contracts (Nos. 110258 and 110259) under Rate Schedule FTS-1. The agreement and contracts have a term beginning April 1, 2004 and continuing until March 31, 2007. Transportation under the contracts takes place November 1 through March 31 of each year. As discussed below, the Commission will accept the negotiated rate agreement proposed by ANR.

2. The negotiated rate includes a fixed annual demand fee of $2,700,000 which NJRES must pay. The agreement provides that this fee would compensate ANR for the variable costs it would otherwise recover in its usage charges, as well as other surcharges, except the Annual Charge Adjustment (ACA). NJRES also must pay the ACA as well as the Transporter's Use charges for Rate Schedules FTS-1 and FSS.[1] The agreement also provides for the sharing of NJRES' revenue from its physical sale of gas plus any NYMEX or seasonal storage spreads earned by NJRES associated with NJRES' use of the agreement. The agreement requires NJRES to maintain a "Shared Account" into which it will record the subject revenue. For each annual period, the positive amounts in the Shared Account will be shared between ANR and NJRES according to the following schedule:

[1] The demand fee is billed at $385,714 per month during April through October of each year. The transportation term is November through March of each year.

$0 - $2,700,000	NJRES - 100%
$2,700,000.01 - $4,000,000	ANR - 75%/NJRES - 25%
$4,000,000.01 +	ANR - 50%/ NJRES – 50%

3. ANR is permitted to withdraw money from the Shared Account January 31, February 28, and March 31 of each year. If, during any annual period ANR's portion of the Shared Account equals $4,956,344, 100 percent of any additional revenues will be retained by NJRES. The negotiated rate agreement states that during each annual period of the agreement, NJRES may not pay ANR more that NJRES would have paid under the applicable Rate Schedules FTS-1 and FSS maximum rates, or less than the demand fee of $2.7 million.

4. NJRES has the right to extend the agreement for one year if the Shared Account does not yield any net revenues to NJRES during the primary term of the agreement.

5. ANR argues that the agreement meets all the conditions the Commission imposed in permitting the use of formulas, including those based on commodity price indices for discounted rate agreements,[2] and therefore the Commission should accept the agreement. ANR states that the effective rate it can recover is capped at ANR's just and reasonable maximum tariff rate for the storage and transportation services it is providing. ANR also states that the agreement encourages competition in the transportation capacity market in line with Commission goals, and results in a market sensitive transportation rate. ANR states that, there is little danger that NJRES or ANR could take any action that would significantly affect NYMEX pricing because the arrangement is for only 6 Bcf of storage capacity, whereas approximately 190,000 Bcf of gas is traded on the NYMEX.

6. ANR states that it will share the risk in this arrangement with NJRES. ANR bears the risk associated with the deeply discounted reservation fee, while NJRES bears the risk associated with holding the capacity and purchasing gas and making it available for sale. ANR also states that is will post the details of the agreement to minimize the risk of undue discrimination.

7. Public notice of ANR's filing was issued with interventions and protests due as provided in section 154.210 of the Commission=s regulations (18 C.F.R. ' 154.210 (1999). Pursuant to Rule 214 (18 C.F.R. ' 385.214 (1999)), all timely filed motions to intervene and any motions to intervene out-of-time filed before the issuance date of this order are granted. Granting late intervention at this stage of the proceeding will not disrupt the proceeding or place additional burdens on existing parties. No adverse comments or protests were filed.

[2] Northern Natural Gas Co., 105 FERC ¶ 61,299 (2003).

Discussion

8. ANR proposes to charge a negotiated rate based upon a demand rate which includes its variable costs and a revenue sharing mechanism whereby it shares in the revenues that NJRS will receive from gas sales and by using NYMEX index prices under basis or seasonal differentials associated with NJRS' use of the subject negotiated agreement.

9. Under the Commission's negotiated rate program, the pipeline and a shipper may negotiate rates that vary from a pipeline's otherwise applicable cost-of-service tariff rate.[3] However, of import here, on July 9, 2003, the Commission issued an order modifying its negotiated rate policies so that the use of gas basis differentials to price negotiated transactions was prohibited.[4] The Commission explained that the Commission's traditional regulation of pipelines' transportation rates ordinarily minimizes the pipelines' incentive to withhold capacity, because even if the pipeline creates scarcity, it cannot charge rates above the maximum just and reasonable rate established by the Commission based upon the pipeline's cost of service and therefore such action could not increase its revenues. However, the Commission's negotiated rate policy permits pipelines to charge rates above the maximum cost of service rate. As a result, a pipeline charging negotiated rates tied to basis differentials could increase its revenues by withholding capacity in order to increase the relevant basis differentials. Therefore, the Commission prohibited the use of natural gas indices in pricing negotiated rate transactions.

10. Subsequently, in Northern Natural Gas Company, (Northern Natural), the Commission determined that it would permit the use of basis differentials in discounted rate transactions.[5] The Commission reasoned that its concerns about the use of basis differentials in negotiated rates were not present to the same degree in the context of discounted rates based on basis differentials. That is because discounted rates, unlike

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[3] The Commission's negotiated rate policies were originally established in, Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines, Regulation of Negotiated Transportation Services, Statements of Policy and Comments, 74 FERC & 61,076 (1996), order on clarification, 74 FERC & 61,194 (1996), order on reh'g, 75 FERC & 61,024 (1996). Under this program, however, a cost-based recourse rate must be maintained by the pipeline for customers that prefer traditional cost-of-service rates and to mitigate market power if the pipeline unilaterally demands excess prices or withholds service. This cost based recourse rate ameliorates the pipeline's exercise of market power by assuring that the customer can fall back to the just and reasonable tariff rate if the pipeline unilaterally demands excessive prices or withholds service.

[4] Natural Gas Pipeline Negotiated Rate Policies and Practices, 104 FERC ¶ 61,134 (2003). (Policy Statement)

[5] Northern Natural Gas Co., 105 FERC ¶ 61,299 (2003).

negotiated rates, are capped by the pipeline's maximum cost-of-service rate. Thus, the concern about basis differential pricing giving the pipeline an incentive to withhold capacity in order to achieve higher revenues than would be possible under its maximum cost-of-service rates is not present in the discounted rate context. Given this fact, the Commission found that that the benefits of allowing the use of basis differentials to price transportation service in discount agreements outweighed any potential harm through giving the pipeline an incentive to withhold capacity.

11. ANR has entered into the instant agreement pursuant to its negotiated rate authority,[6] not its discount rate authority. However, ANR argues that while the Commission's policy ordinarily does not permit the use of index prices in negotiated rate agreements, its proposal satisfies the conditions that the Commission found determinative in Northern Natural in permitting index based discounts under its discount policy. Specifically, ANR asserts "although the NJRES Agreement contemplates using the NYMEX to hedge the capacity only NJRES may engage in this activity and the effective rate that ANR can recover is capped at the approved just and reasonable maximum rate stated in ANR's FERC Gas Tariff for the respective storage and transportation services that ANR is providing."[7]

12. Under the proposed contracts, ANR agrees to cap the annual revenue that it might earn from this proposal at the amount it would have earned on an annual basis if it had charged the maximum tariff rate for the services involved.[8] In the Policy Statement the Commission stated its concern that the use of gas basis index pricing in negotiated rates could give the pipeline an incentive to withhold capacity in order to achieve higher revenues than would be possible under its maximum cost of service rates, because negotiated rates are not subject to a maximum rate. This concern was lessened in Northern Natural because under the discounting program the rate charged could not exceed the maximum rate and, therefore, the Commission permitted the use of price indices to value capacity in discounted rate transactions.

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[6] Transmittal Letter at 1, citing, ANR Pipeline Co., 87 FERC ¶ 61,241 (1999).

[7] Transmittal Letter at 2, 3.

[8] The contracts filed by ANR state:

> [d]uring each annual period of this Service Agreement, in no event shall NJRES pay ANR, as a part of this Negotiated Rate Agreement, more than NJRES would have paid under the applicable maximum FTS-1 transportation rates and the applicable maximum FSS storage rates, including surcharges and Transporter's Use charges, or less than the annual demand fee of $2,700,000. If, for each April – March period, ANR's portion of the Shared Account equals $4,956,344 then 100% of any further revenues will be kept by NJRES.

13. In the instant case, the Commission similarly finds that ANR's proposal to restrict its annual revenues to no more than it could earn on an annual basis if it charged its maximum tariff rate for the services rendered, also reduces the Commission's concerns regarding the pipeline's incentive to withhold capacity in order to manipulate gas prices. The revenue cap provided for in the negotiated rate proposal assures that, on an annual basis, ANR can obtain no more revenue than if it charged NJRES its maximum cost of service rate. Therefore, the Commission finds that this proposal will permit the parties to negotiate market sensitive rates consistent with the Commission's goal of encouraging competition in the transportation capacity without creating an incentive for market manipulation. Accordingly, the Commission accepts ANR's filing to be effective April 1, 2004.

By direction of the Commission. Chairman Wood dissenting with a separate statement attached.
Commissioner Kelly not participating.

Linda Mitry,
Acting Secretary.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

ANR Pipeline Company Docket No. RP99-301-108

(Issued April 9, 2004)

Wood, Chairman, dissenting:

I would not have approved this proposed negotiated rate agreement because it gives the pipeline a direct interest in natural gas commodity prices. As I have stated previously, I believe that one of the greatest benefits to customers from natural gas restructuring in Order No. 636 was the unbundling of pipelines' regulated transportation service from competitive commodity sales service, thus establishing the clear role of pipelines as open access transporters with no direct interest in the price of the commodity. Columbia Gulf Transmission Co., 100 FERC ¶ 61,047 (2002). In our Negotiated Rate Policy Statement we prohibited the use of basis differential pricing in negotiated rate transactions due to the potential for the pipeline to increase its revenues by withholding capacity in order to increase the relevant basis differentials. Natural Gas Pipeline Negotiated Rate Policies and Practices, 104 FERC ¶ 61,134 (2003). There we stated:

> Pricing mechanisms that invest pipelines with an incentive to use market power to manipulate the commodity price of gas hinder the Commission's attempt to maintain and improve the competitive natural gas market. To allow pipelines to acquire an interest in commodity prices, or more precisely the difference between the commodity prices at separate points, reverses the regulatory trend which is based upon the competitive transportation structure acting to ensure competitive natural gas markets. This interest in the prices of the natural gas commodity presents pipelines with an incentive to withhold existing capacity in order to manipulate natural gas prices and may also create a disincentive to invest in the expansion of capacity.

104 FERC at P 22. I remain concerned about any negotiated rate agreement that gives a pipeline an interest in the commodity prices because of the incentive it creates to manipulate the market.

In this case ANR's proposed negotiated rate agreement with NJRES is inconsistent with the Commission's negotiated rate policy, since it gives ANR a direct interest in the price of gas. Under the proposed agreement, ANR would share the revenues from the physical sale of gas under NJRES' gas sales agreements. Therefore, ANR would have an interest in higher commodity prices and an incentive to manipulate the market to achieve such prices.

I recognize that we have subsequently permitted the use of basis differentials in discounted rate transactions. Supra. P 10, citing Northern Natural Gas Co., 105 FERC ¶ 61,299 (2003). However, there we were convinced that the benefits of allowing basis differentials to value the transportation service outweighed the potential harm of giving the pipeline an incentive to withhold capacity largely because the rates were capped at the pipeline's maximum cost-of-service. ANR's proposal, however, goes beyond using basis differentials to value the transportation service and gives the pipeline a direct interest in commodity prices by allowing ANR to share the revenues from the physical sale of gas under NJRES' gas sales agreements.

ANR's proposal is contrary to the Commission's negotiated rate policies. Accordingly, I respectfully dissent.

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Pat Wood, III
Chairman