113 FERC ¶ 61,173
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Nora Mead Brownell, and Suedeen G. Kelly.

Policy for Selective Discounting By Natural Gas Pipelines | Docket No. RM05-2-001

ORDER DENYING REHEARING

(Issued November 17, 2005)

1. On May 31, 2005, the Commission issued an order (May 31 Order)[1] in this proceeding reaffirming the Commission's current policy on selective discounting. Timely requests for rehearing of that order were filed by the Illinois Municipal Gas Agency (IMGA) and, jointly by Northern Municipal Distributor Group and the Midwest Region Gas Agency (Northern Municipals). For the reasons discussed below, the requests for rehearing are denied.

Background

2. The prior orders in this proceeding set forth the background and development of the Commission's selective discounting policy.[2] Generally, as explained in those orders, the Commission's regulations permit pipelines to discount their rates, on a nondiscriminatory basis, in order to meet competition. For example, if a fuel-switchable shipper were able to obtain an alternate fuel at a cost less than the cost of gas including the transportation rate, the Commission's regulations permit the pipeline to discount its rates to compete with the alternate fuel, and thus obtain throughput that would otherwise be lost to the pipeline. As the Commission has explained, these discounts benefit all customers, including customers that do not receive the discounts, because the discounts allow the pipeline to maximize throughput and thus spread fixed costs across more units of service. Further, as the Commission has explained, selective discounting protects captive customers from rate increases that would otherwise occur if pipelines lost

[1] 111 FERC ¶ 61,309 (2005).

[2] 109 FERC ¶ 61,202 at P 2-10; 111 FERC ¶ 61,309 at P3-8.

volumes through the inability to respond to competition. The Commission's regulations permitting selective discounting were upheld by the court in *Associated Gas Distributors v. FERC (AGD I).*[3]

3. The prior orders also explained the rationale behind the Commission's policy of allowing a discount adjustment and stated that the adoption of the discount adjustment resulted from the court's discussion in *AGD I.* In *AGD I*, the court addressed arguments raised by pipelines that the selective discounting regulations might lead to the pipelines under-recovering their costs. The court set forth a numerical example showing that the pipeline could under-recover its costs, if, in the next rate case after a pipeline obtained throughput by giving discounts, the Commission nevertheless designed the pipeline's rates based on the full amount of the discounted throughput, without any adjustment.[4] However, the court found no reason to fear that the Commission would employ this "dubious procedure,"[5] and accordingly rejected the pipelines' contention.

4. In response to the court's concern, the Commission, in the 1989 *Rate Design Policy Statement*,[6] held that if a pipeline grants a discount in order to meet competition, the pipeline is not required in its next rate case to design its rates based on the assumption that the discounted volumes would flow at the maximum rate, but may reduce the discounted volumes so that the pipeline will be able to recover its cost of service. The Commission explained that if a pipeline must assume that the previously discounted service will be priced at the maximum rate when it files a new rate case, there may be a disincentive to pipelines discounting their services in the future to capture marginal firm and interruptible business.

5. Since *AGD I* and the Rate Design Policy Statement, the issue of "gas-on-gas" competition, *i.e.*, where the competition for the business is between pipelines as opposed to competition between gas and other fuels, has been raised in several Commission proceedings.[7] In these proceedings, certain parties have questioned the Commission's

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[3] 824 F.2d 981, 1010-12 (D.C. Cir. 1987).

[4] *Id.* at 1012.

[5] *Id.*

[6] *Interstate Natural Gas Pipeline Rate Design*, 47 FERC ¶ 61,295, *reh'g granted*, 48 FERC ¶ 61,122 (1989).

[7] IMGA raised this issue in a petition for rulemaking in Docket No. RM97-7-000. In the NOI, the Commission stated that it would consider all comments on this issue in Docket No. RM05-2-000 and terminated the proceeding in Docket No. RM97-7-000.

rationale for permitting discount adjustments, *i.e*., that it benefits captive customers by allowing fixed costs to be spread over more units of service. These parties have contended that, while this may be true where a discount is given to obtain a customer who would otherwise use an alternative fuel and not ship gas at all, it is not true where discounts are given to meet competition from other gas pipelines. In the latter situation, these parties have argued, gas-on-gas competition permits a customer who must use gas, but has access to more than one pipeline, to obtain a discount. But, if the two pipelines were prohibited from giving discounts when competing with one another, the customer would have to pay the maximum rate to one of the pipelines in order to obtain the gas it needs. This would reduce any discount adjustment and thus lower the rates paid by the captive customers.

6. On November 22, 2004, the Commission issued a Notice of Inquiry (NOI) seeking comments on its policy regarding selective discounting by natural gas pipelines.[8] The Commission asked parties to submit comments and respond to specific questions regarding whether the Commission's practice of permitting pipelines to adjust their ratemaking throughput downward in rate cases to reflect discounts given by pipelines for competitive reasons is appropriate when the discount is given to meet competition from another natural gas pipeline. The Commission also sought comments on the impact of its policy on captive customers. Comments were filed by 40 parties.

7. On May 31, 2005, after reviewing the comments, the Commission issued an order[9] reaffirming the Commission's current selective discounting policy. The Commission concluded that, in today's dynamic natural gas market, any effort to discourage pipelines from offering discounts to meet gas-on-gas competition would do more harm than good. Accordingly, the Commission decided not to modify its 16-year old policy to prohibit pipelines from seeking adjustments to their rate design volumes to account for discounts given to meet gas-on-gas competition.

8. The May 31 Order stated that interstate pipelines face three types of so-called gas-on-gas competition: (1) competition from other interstate pipelines subject to the Commission's NGA jurisdiction, (2) competition from capacity releases by the pipeline's

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The Commission explained that the issues included in Docket No. RM05-2-000 include all the issues raised in the Docket No. RM97-7-000 proceeding. IMGA did not seek rehearing of the Commission's decision to terminate Docket No. RM97-7-000 proceeding and did not in its comments object to the procedural forum offered to it in Docket No. RM05-2-000.

[8] 109 FERC ¶ 61,202 (2004).

[9] 111 FERC ¶ 61,309 (2005).

own firm customers, and (3) competition from intrastate pipelines not subject to the Commission's jurisdiction. The May 31 Order recognized that a significant portion of pipeline discounts are given to meet competition from other interstate pipelines. Some commenters contended that customers receiving such discounts are not fuel switchable and thus would take the same amount of gas even if required to pay the maximum rate of whichever pipeline they choose to use. The Commission rejected this contention, finding that discounts to non-fuel switchable customers can increase throughput and thus benefit captive customers. The Commission pointed to at least five examples of why this is so.

9. First, the Commission stated that industrial and other business customers of pipelines typically face considerable competition in their own markets and must keep their costs down in order to prosper. Lower energy costs achieved through obtaining discounted pipeline capacity can help them do more business than they otherwise would, thereby increasing their demand for gas.

10. Second, discounts may reduce the incentive for existing non-fuel switchable customers to install the necessary equipment to become fuel switchable. In addition, potential new customers, such as companies considering the construction of gas-fired electric generators, may be more likely to build such generators if they obtain discounted capacity on the pipeline.

11. Third, the Commission stated that an LDC’s need for interstate pipeline capacity depends upon the demand of their customers for gas, and that demand is elastic, since some of their customers are fuel switchable. They also have non-fuel switchable industrial or business customers whose gas usage may vary depending upon cost.

12. Fourth, pipeline discounts may enable natural gas producers to keep marginal wells in operation for a longer period and affect their decisions on whether to explore and drill for gas in certain areas with high production costs.

13. Finally, the Commission pointed out that on many pipeline systems, the bulk of the pipelines’ discounts are given to obtain interruptible shippers. All interruptible shippers may reasonably be considered as demand elastic, regardless of whether they are fuel switchable, since their choice to contract for interruptible service shows that they do not require guaranteed access to natural gas.

14. The Commission thus found no basis to conclude that overall interstate pipeline throughput would remain at the same level, if the Commission discouraged interstate pipelines from giving discounts in competition with one another. The Commission also found that, apart from the issue of the extent to which such discounts increase overall throughput on interstate pipelines, discounts arising from competition between interstate pipelines provide other substantial public benefits, which would be lost if the Commission sought to discourage such discounting. The Commission pointed out that,

as a result of increased competition in the gas commodity and transportation markets, there are now market prices for the gas commodity in the production area and for delivered gas in downstream markets. The difference between these prices (referred to as the "basis differential") shows the market value of transportation service between those two points.

15. The May 31 Order found that discounting pipeline capacity to the market value indicated by the basis differentials provides a number of benefits. First, such discounting helps minimize the distorting effect of transportation costs on producer decisions concerning exploration and production. Second, if several interstate pipelines serve the same downstream market, discounting can help minimize short-term price spikes in response to increases in demand by making the higher cost pipeline more willing to discount down to the basis differential in order to bring more supplies to the downstream market. Third, discounting enables interstate pipelines with higher cost structures to compete with lower cost pipelines. Fourth, discounting helps facilitate discretionary shipments of gas into storage during off-peak periods. Finally, selective discounting helps pipelines more accurately assess when new construction is needed.

16. In addition, the May 31 Order found that a discount adjustment for discounts given in competition with capacity release promotes the Commission's goal of creating a robust competitive secondary market, and that discouraging pipelines from competing in this market would defeat the purpose of capacity release and eliminate the competition that capacity release has created. The Commission also pointed out that capacity release provides substantial benefits to captive customers. Similarly, the Commission determined in the May 31 Order that there was no reason to create an exemption from the selective discounting policy for expansion capacity. However, the Commission stated that under the Commission's current policy as set forth in the *Certification of New Interstate Natural Gas Pipeline Facilities* (*Certificate Pricing Policy Statement*),[10] unless the new construction benefits current customers, the services must be incrementally priced and the Commission would not approve a discount adjustment that would shift costs to current customers.

17. IMGA and Northern Municipals seek rehearing of the May 31 Order. Generally, these parties argue that the May 31 Order is not based on substantial or factual evidence, that the selective discount policy does not benefit captive customers, that the Commission has not properly assigned the burden of proving that discounts were given to meet

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[10] 88 FERC ¶ 61,227 (1999), *order on clarification*, 90 FERC ¶ 61,128 (2000), *order on further clarification*, 92 FERC ¶ 61,094 (2000).

competition, and that the Commission did not address certain arguments of the parties that oppose the policy. The issues raised in the requests for rehearing are discussed below.

Discussion

A. Procedural Matters

18. The NOI invited interested persons to submit comments and other information on the matters raised by the NOI within 60 days. The NOI did not provide for reply comments. Forty parties submitted comments in response to the NOI. Only one party, IMGA, filed reply comments. In the May 31 Order, the Commission found that in these circumstances, it would not consider IMGA's reply. On rehearing, IMGA argues that it was error for the Commission to reject their reply comments.

19. The Commission has broad discretion to establish the procedures to be used in carrying out its responsibilities.[11] In this case, the Commission sought comments and responses to specific questions from interested parties, but did not authorize the filing of replies to the comments. Because reply comments were not authorized and IMGA was the only party to file reply comments, the Commission reasonably determined that it would not be appropriate or fair to the other parties in the proceeding to consider IMGA's reply comments. This was not error and was clearly within the Commission's discretion. In any event, IMGA's request for rehearing sets forth the arguments that IMGA made in its reply comments and those arguments are addressed in this order.

B. Substantial Evidence in Support of the Policy

20. Throughout their requests for rehearing, both IMGA and Northern Municipals argue that the Commission's decision is not supported by substantial evidence because it is not based on facts and empirical data, but is based on theory and speculation. Northern Municipals assert that the Commission has not provided any hard data or factual support for its conclusion that the selective discounting policy will increase overall throughput and benefit captive customers. Instead, Northern Municipals state, the Commission posited a number of examples that might lead to increased throughput. However, they argue, the Commission failed to quantify any increase in throughput, failed to analyze whether the increase would be in the form of an overall increase to the national grid or simply an increase to one pipeline and a decrease to another, and failed to analyze whether the benefits of such an increase to captive and other customers would be

[11] *E.g., Mobile Oil Exploration & Producing Southeast, Inc. v. United Distrib. Cos.*, 498 U.S. 211, 230 (1991); *Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc.*, 435 U.S. 519, 524-25, 543 (1978).

outweighed by the costs of subsidizing the discounts. Similarly, IMGA argues that the May 31 Order merely adopts the comments of the supporters of the policy and that those comments were based on allegation and speculation, rather than substantial evidence.

21. Northern Municipals assert that the Commission should engage in a cost/benefit analysis of the policy and should review all orders issued on the merits for base rate cases for a period of time to determine how often discount adjustments were allowed and whether pipelines routinely file for such adjustments. If discounts are routinely allowed, Northern Municipals argue, that is an indication that the pipeline considers the recovery of discounts an entitlement, and this undermines the validity of the Commission's premise that pipelines will always seek the highest rate for their service.

22. While the Commission will address below Northern Municipals' and IMGA's arguments regarding the basis for each of the Commission's challenged findings, some general comments about the type of evidence considered in this proceeding are appropriate at the outset. Rehearing applicants ask the Commission to change a policy of 16 years and establish a blanket rule that prohibits pipelines from seeking a discount adjustment in a rate case for discounts given to meet gas-on-gas competition. While the permission given by the Commission to pipelines to discount their rates between a minimum and maximum rate was promulgated in Order No. 436 and adopted as a regulation,[12] the adjustment in throughput to recognize discounting is not a rule, but is a policy that was adopted by the Commission in the *Rate Design Policy Statement.*[13] Therefore, in individual rate cases, the parties are free to develop a record based on the specific circumstances on the pipeline to determine whether the discounts given were beneficial to captive customers. The pipeline has the burden of proof under section 4 of the NGA in a rate case to show that its proposal is just and reasonable. If there are circumstances on a particular pipeline that may warrant special considerations or disallowance of a full discount adjustment, those issues may be addressed in individual proceedings.[14] Parties in a rate proceeding may address not only the issue of whether a discount was given to meet competition, but also issues concerning whether the discount was a result of destructive competition and whether something less than a full discount adjustment may be appropriate in the circumstances.

[12] 18 C.F.R. § 284.10 (2005).

[13] *Interstate Natural Gas Pipeline Rate Design*, 47 FERC ¶ 61,295, *reh'g granted*, 48 FERC ¶ 61,122 (1989).

[14] *See, e.g., Natural Gas Pipeline Company of America*, 73 FERC ¶ 61,050 at 61,128-29 (1995), and *El Paso Natural Gas Co.*, 72 FERC ¶ 61,083 at 61,441 (1995).

23. The November 22 NOI gave all participants in the natural gas industry an opportunity to provide comments on whether gas-on-gas discounts help increase overall throughput on interstate pipelines and asked specific questions concerning whether customers receiving such discounts could increase their throughput. The Commission did this to develop a record upon which to base its decision whether to change the selective discounting policy. Forty parties filed comments. The Commission appropriately relies on the record developed and the comments of experienced industry participants. Because the Commission provided all interested parties with an opportunity to present evidence, it need not now undertake a separate and independent analysis.

24. Further, the Commission need not undertake such an analysis for the purposes of determining whether, as Northern Municipals allege, the Commission's rationale for the policy is undermined because discount adjustments are "routinely" granted and pipelines therefore consider them an entitlement. The Commission does not routinely grant pipelines a discount adjustment, but grants such an adjustment only to the extent that the discount was required to meet competition. The Commission has denied pipelines the adjustment where the pipeline has failed to meet its burden of showing that the discount was required to meet competition. For example, in *Panhandle Eastern Pipe Line Co*,[15] *Williams Natural Gas Co*,[16] and *Trunkline Gas Co.*,[17] the Commission held that the pipeline had not met its burden to show that its discounts to its affiliates were required by competition. In addition, in *Iroquois Gas Transmission System*[18] and *Trunkline Gas Co.*,[19] the Commission disallowed a discount adjustment with respect to discounts given to non-affiliates. In both cases, the discounts were given to long-term, firm customers. The Commission found that the parties opposing the discount adjustment had raised enough questions about the circumstances in which those long-term discounts were given to shift the burden back to the pipeline to justify the discount. The Commission then found that, when a pipeline gives a long-term discount, the Commission would expect that the pipeline would make a thorough analysis whether competition required such a long-term discount, and in both these cases the pipeline had failed to present any evidence of such an analysis. A discount adjustment is not an entitlement and the pipelines would be ill-advised to consider it so.

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[15] 74 FERC at ¶ 61,109 at 61,401-02 (1996).

[16] 77 FERC at ¶ 61,277 at 62,206-07 (1996).

[17] 90 FERC at ¶ 61,017 at 61,096 (2000).

[18] 84 FERC at ¶ 61,086 at 61,476-78 (1998).

[19] 90 FERC at ¶ 61,017 at 61,092-95 (2000).

25. Moreover, the Commission need not conduct such a fact-specific analysis in order to meet the requirement that its decision be supported by substantial evidence. In *AGD I*, the court explained that promulgation of generic rate criteria involves the determination of policy goals and the selection of the means to achieve them, and that courts do not insist on empirical data for every proposition on which the selection depends.[20] The court cited *Wisconsin Gas Co. v. FERC*,[21] where certain parties had objected to the Commission's curtailment of the minimum bill because it allegedly would result in shifting costs to captive customers. In response to these arguments, the Commission stated that the increased incentive to compete vigorously in the market would eventually lead to lower prices for all consumers. The court noted that the *Wisconsin Gas* court accepted this response without record evidence "presumably because it viewed the prediction as at least likely enough to be within the Commission's authority."[22] The court further stated "agencies do not need to conduct experiments in order to rely on the prediction that an unsupported stone will fall; nor need they do so for predictions that competition will normally lead to lower prices."[23]

26. Similarly in *INGAA v. FERC*,[24] the Commission narrowed the right of first refusal (ROFR) to eliminate the ROFR for discounted contracts. In justifying this change, the Commission stated that if a customer is truly captive, it is likely that its contract will be at the maximum rate. Parties challenged this finding as not being based on substantial evidence, but rather on the agency's own supposition and presented hypothetical examples to the contrary. The court upheld the Commission and stated that while the Commission had cited no studies or data, its conclusion seemed largely true by definition and that it was a "fair inference" that customers paying less than the maximum rate for service had other choices in the market. The court further found that the hypothetical counter examples given by the petitioners failed to undermine the Commission's conclusion that generally, discounts are given in order to obtain and retain load that the pipeline could not transport at the maximum rate because of competition.

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[20] 824 F.2d at 1008.

[21] 770 F.2d 1144 (D.C. Cir. 1985).

[22] 824 F.2d at 1008.

[23] *Id.* at 1008-09.

[24] 285 F.3d 18 at 55 (D.C. Cir. 2002).

27. In *AGD I*, the court cited to economic treatises in reaching its decision,[25] and courts rely on economic theory in their decisions. For example, the decisions in *Williston Basin v. FERC*,[26] *Iroquois Gas Transmission System v. FERC*,[27] and *Arco Alaska, Inc. v. FERC*,[28] rely on economic theory in reaching their conclusions. Therefore, the Commission rejects the arguments of Northern Municipals and IMGA that the May 31 Order is not based on substantial evidence because it relies on economic theory rather than empirical data. To the extent that the Commission's orders on the selective discounting policy rely on economic theory, that is entirely proper, and economic theory may be the basis for the Commission's decision.

C. Legal Basis for Upholding the Policy

28. In the May 31 Order, the Commission discussed its responsibilities under the NGA and cited to Order No. 636:

> The Commission's responsibility under the NGA is to protect the consumers of natural gas from the exercise of monopoly power by the pipelines in order to ensure consumers 'access to an adequate supply of gas at a reasonable price.' [*Tejas Power Corp. v. FERC*, 908 F.2d 998, 1003 (D.C. Cir. 1990).] This mission must be undertaken by balancing the

[25] *Id.* at 1010 (citing 2 A. Kahn, *The Economics of Regulation: Principles and Institutions* (1987)), 1011n.12 (citing E. Gellhorn & R. Pierce, *Regulated Industries* 185-89 (1987)), and n.13 (citing, *inter alia*, Tye & Leonard, *On the Problems of Applying Ramsey Pricing to the Railroad Industry with Uncertain Demand Elasticities*, 17A Transportation Research 439 (1983)).

[26] 358 F.3d 45, 49-50 (D.C. Cir. 2004) (citing Alfred E. Kahn, *The Economics of Regulation: Principles and Institutions* 132-33 (1988)).

[27] 172 F.3d 84, 89 (D.C. Cir. 1999)("We note that classic analysis of non-cost-based discounting by carriers has turned on differences in the price elasticity of demand for the carried product. It pursues the goal of an optimal trade-off between the desirability of maximizing output and the necessity of the utility's recovering all its costs.").

[28] 89 F.3d 878, 883 (D.C. Cir. 1996) (Explaining the now "inverse-elasticity rule, Ramsey Pricing, allocates joint costs in inverse proportion to the demand elasticities of different customers to yield the most efficient use of a pipeline.).

> interests of the investors in the pipeline, to be compensated for the risks they have assumed, and the interests of consumers, and in light of current economic, regulatory, and market realities.[29]

The Commission then concluded that, in light of existing conditions in the natural gas market, its existing policies concerning selective discounting are more consistent with the goal of ensuring adequate supplies at a reasonable price, than any of the alternatives proposed in the comments in response to the NOI.

29. On rehearing, IMGA argues that the Commission did not apply the proper legal criteria in reaching its conclusion. IMGA argues that the selective discount policy is unlawful unless it can be shown that it produces a net benefit to captive customers[30] and that the burden of proof is on the supporters of the policy to produce substantial evidence to show that the discount adjustment benefits captive customers. It argues that the Commission's cite to *Tejas* was taken out of context and that it is a "perversion of the ruling in *Tejas Power Corp.* to employ it to support a conclusion that it is okay to exploit captive customers where that exploitation could arguably increase gas supply because it produces higher prices." IMGA states that regardless of whether higher gas prices is a lawful objective, it is not lawful if the mechanism produces a violation of the prohibition against undue discrimination of sections 4 and 5 of the NGA. Further, IMGA argues, it is of no benefit to captive shippers that the discount adjustment reduces their transportation costs if it also increases their gas supply costs, and that in *Maryland People's Counsel v. FERC,* [31] the court concluded that it was unlawful for the Commission to focus only on the benefits of lower transportation costs and ignore the potential offsetting impact of higher gas prices.

30. The Commission has correctly stated its responsibilities under the NGA. The citation to Order No. 636 and *Tejas* merely state, as do numerous other Commission and

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[29] Order No. 636 at 30,392.

[30] IMGA cites the Order No. 637 NOPR, *Transcontinental Gas Pipe Line Corp. v. FERC,* 998 F.2d 1313, 1318, 1321 (D.C. Cir. 1993); *Columbia Gas Transmission Corp. v. FERC*, 848 F.2d 250, 251-254 (D.C. Cir. 1988); *Maryland People's Counsel v. FERC*, 761 F.2d 768, 770-771 (D.C. Cir. 1985).

[31] IMGA cites 761 F.2d 768, 770-71 (D.C. Cir. 1988).

court decisions,[32] that the Commission's responsibility under the NGA is to ensure customers access to natural gas at reasonable prices, and that in carrying out its mission, the Commission must balance a number of competing interests. In Order No. 636, the Commission cited to the Natural Gas Wellhead Decontrol Act of 1989 (Decontrol Act),[33] enacted by Congress in order to create more abundant natural gas supplies at lower prices by creating competition among efficient producers.[34] The House Committee Report urged the Commission to "retain and improve" the competitive structure in natural gas markets in order to maximize the benefits of wellhead price decontrol. [35] The Decontrol Act did not, however, alter the Commission's consumer protection mandate.

31. Thus, the Commission must, in all of its decisions, balance a number of interests, and that is what it has done here. The Commission recognizes its obligation to protect captive customers and it has met that obligation here. However, the Commission also has broad responsibilities to develop policies of general applicability. The Commission has analyzed the concerns of IMGA and Northern Municipals in the context of the overall benefits to the national pipeline system provided by the selective discount policy. The Commission has concluded that the selective discount policy, including allowing a discount adjustment for gas-on-gas competition, generally benefits all customers including customers who do not receive the discount.

32. We find IMGA's view of the Commission's responsibilities too narrow. Under IMGA's view, if there could be circumstances where a discount does not benefit captive customers then the policy must be abandoned. While the Commission has concluded that the selective discounting policy generally benefits all customers, it has also recognized that there may be circumstances on some pipelines where captive customers may require additional protections. It is not necessary, however, for the Commission to eliminate entirely the discount adjustment for gas-on-gas competition in order to address those limited situations. The cases cited by IMGA are not to the contrary.

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[32] *E.g., FPC v. Hope Natural Gas Co.,* 320 U.S. 591, 603 (1943); *Atlantic Refining Co. v. Public Service Commission of New York,* 360 U.S. 378, 388, 389, 392 (1959)(fundamental purpose of NGA is to assure the public of a reliable supply of gas at reasonable prices).

[33] 103 Stat. 157 (1989).

[34] Order No. 636, Regulations Preambles ¶ 30,939 at p. 30,397 (1992), citing H.R. Report No. 29, 101st Cong., 1st Sess., at p. 2 (1989).

[35] H.R. Report No. 29, *supra*, at p.2.

33. As the Commission explained in the May 31 Order, it is possible to adopt measures to protect small publicly-owned municipal gas companies in circumstances where the policy works an undue hardship on them and at the same time retain the competitive benefits of the policy for the majority of shippers. This is the proper balancing of interests in this proceeding and the Commission applied the appropriate legal standards in balancing these interests. The Commission's decision here meets both goals of promoting a competitive natural gas market and protecting captive customers. This is the type of balancing decision that the courts have recognized is within the Commission's discretion in developing its policies in a competitive market place.[36]

34. IMGA's characterization of the Commission's decision as concluding that it is "okay" to exploit captive customers where that exploitation could increase gas supply by producing higher prices is not an accurate characterization of the Commission's decision. As stated above, it is the Commission's responsibility to ensure that consumers have access to natural gas at reasonable prices, not to promote policies that increase prices, and there is no basis for concluding that the discount policy increases the delivered price of natural gas to consumers. Further, it is clearly established that selective discounting based on different demand elasticities does not constitute undue discrimination under the NGA.[37]

D. <u>There is Substantial Evidence to Support The Commission's Conclusion That Discouraging Discounts Would Do More Harm Than Good</u>

35. IMGA and Northern Municipals argue that the Commission's decision that discouraging gas-on-gas discounting by disallowing any adjustment to rate design volumes to account for such discounts would do more harm than good is not based on substantial evidence. They raise a number of issues which, they allege, the Commission either failed to address or did not adequately address in the May 31 Order. As the May 31 Order stated, there are three different categories of gas-on-gas competition. One category is competition from other interstate pipelines subject to the Commission's jurisdiction. The second category is competition from capacity releases by the pipeline's own firm customers. The third category is competition from interstate pipelines that are not subject to the Commission's jurisdiction. The May 31 Order gave different reasons for allowing discount adjustments for each of these categories of gas-on-gas discounts.

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[36] *See, e.g., Midcoast Interstate Transmission, Inc. v. FERC,* 198 F.3d 960, 970 (D.C. Cir. 2000).

[37] *E.g., AGD I* at 1011; *United Distribution Companies v. FERC,* 88 F.3d 1105, 1142 (D.C. Cir. 1996).

Accordingly, in addressing the rehearing requests, we will continue to discuss these categories of gas-on-gas competition separately.

1. Competition from Other Interstate Pipelines

36. IMGA and Northern Municipals contend that the Commission erred in not adopting their proposals to adopt a rule prohibiting adjustments to rate design volumes for discounts a pipeline gives in competition with another interstate pipeline. They attack both of the primary bases of the Commission's decision: (1) that gas-on-gas discounts do play a role in increasing throughput on interstate pipelines and (2) such discounts provide substantial other public benefits which would be lost if the Commission sought to discourage such discounting.

37. Before addressing the specific arguments of the two rehearing applicants in support of their position, several general comments are in order. First, the Commission has never codified its policy concerning discount adjustments in any definitive rule or regulation. Rather, the Commission has developed its discount adjustment policy first through the 1989 Rate Design Policy Statement and subsequently in individual rate cases. Under that policy, the pipeline may propose as part of a section 4 rate filing to adjust its rate design volumes to account for any discounts it gave during the test period, including discounts given in competition with other pipelines. By proceeding on this basis, the Commission must find, based on the record developed in each rate case, that the pipeline has met its section 4 burden to show that any approved discount adjustment to rate design volumes is just and reasonable.[38] In addition, as the Commission stated in the May 31 Order[39] and discusses further below, the Commission will consider the impact of any discount adjustment on captive customers in specific proceedings. The Commission's termination of the instant rulemaking proceeding is a decision to continue to address the discount adjustment issue in the same case-by-case manner. Thus, the May 31 Order should not be interpreted as establishing any definitive rule that pipelines will in all instances be permitted a full discount adjustment for discounts given in competition with another pipeline. Rather, the Commission simply determined in the May 31 Order to reject the rehearing applicants’ proposal to establish a definitive rule prohibiting pipelines from proposing in section 4 rate cases discount adjustments with respect to discounts given in competition with other pipelines.

38. Second, the Commission's approach to this issue appropriately balances several factors. Given the increasingly competitive nature of both the gas commodity and

[38] *Pacific Gas & Electric Co. v. FPC,* 506 F.2d 33, 48 (D.C. Cir. 1974).

[39] 111 FERC ¶ 61,309 at P 57.

pipeline capacity markets, the Commission believes there are undeniable public benefits to giving pipelines flexibility to discount their rates consistent with the market value of their capacity, including in the context of competition with other interstate pipelines. At the same time, the Commission must take into account the effect of such discounting on truly captive customers. While the Commission believes that in most instances such discounts either help keep the rates of the captive customers lower than they otherwise would be or are at least neutral in effect, the Commission recognizes that there may be some situations where gas-on-gas discounting could shift costs to the captive customers. However, the Commission believes that such situations are sufficiently isolated that they are best dealt with on a case-by-case basis, rather than by establishing a generic rule discouraging interstate pipelines from giving discounts in competition with one another.

39. The Commission now turns to a discussion of the public benefits of competition between interstate pipelines. The May 31 Order found that pipeline discounts in competition with one another leads to more efficient use of the interstate pipeline grid by enabling pipelines to adjust the price of their capacity to match its market value, and that discouraging such discounting would lead to harmful distortions in both the commodity and capacity markets. On rehearing, IMGA and Northern Municipals argue that there is no substantial evidence in the record to support this conclusion. The Commission disagrees.

40. As the Commission found in both Order No. 637 and the May 31 Order, and as many of the comments in this proceeding reiterate,[40] the deregulation of wellhead natural gas prices, together with the requirement that interstate pipelines offer unbundled open access transportation service, has increased competition and efficiency in both the gas commodity market and the transportation market. Market centers have developed both upstream in the production area and downstream in the market area. Such market centers enhance competition by giving buyers and sellers a greater number of alternative pipelines from which to choose in order to obtain and deliver gas supplies. As a result, buyers can reach supplies in a number of different producing regions and sellers can reach a number of different downstream markets.

41. The development of spot markets in downstream areas means there is now a market price for delivered gas in those markets. That price reflects not only the cost of the gas commodity but also the value of transportation service from the production area to the downstream market. The difference between the downstream delivered gas price and the market price at upstream market centers in the production area (referred to as the "basis differential") shows the market value of transportation service between those two points. As a result, "gas commodity markets now determine the economic value of

[40] *Id.* at P 31.

pipeline transportation services in many parts of the country. Thus, even as FERC has sought to isolate pipeline services from commodity sales, it is within the commodity markets that one can see revealed the true price for gas transportation."[41] These basis differentials vary on a daily and seasonal basis as market conditions change and are largely determined by the gas-on-gas competition that occurs at the market centers.[42]

42. Under the Commission's original cost method of determining just and reasonable rates, the maximum just and reasonable rate in a pipeline's tariff reflects embedded costs and depreciation. As a result, the pipeline's maximum tariff rate need not reflect the market value of its capacity on any given day or season of the year. Moreover, the maximum rates of competing pipelines may substantially differ from one another. Allowing each pipeline to discount its capacity to the market value indicated by the basis differentials taking into account the time period over which the discount will be in effect provides greater efficiency in the production and distribution of gas across the pipeline grid, promoting optimal decisions concerning exploration for and production of the gas commodity and transportation of gas supplies to locations where it is needed the most and during the time periods when it is needed.

43. The May 31 Order gave a number of examples of the public benefits provided by enabling pipelines to discount their rates to the market value. First, such discounting helps minimize the distorting effect of transportation costs on producer decisions concerning exploration and production. Second, discounting enables interstate pipelines with higher cost structures to compete with lower cost pipelines. Third, if several interstate pipelines serve the same downstream market, discounting can help minimize short-term price spikes in response to increases in demand by making the higher cost pipeline more willing to discount down to the basis differential in order to bring more supplies to the downstream market. Fourth, discounting helps facilitate discretionary shipments of gas into storage during off-peak periods. Finally, selective discounting helps pipelines more accurately assess when new construction is needed.

44. IMGA and Northern Municipals contest each of the public benefits found by the Commission. However, a large majority of the commenters in this proceeding affirmed that discounts given by competing pipelines based on the market value of their capacity do produce significant public benefits. IMGA and Northern Municipals do not seriously contest the finding that basis differentials between two points show the current market value of the transportation capacity between those two points. Rather, they suggest, in essence, that by discouraging pipelines from discounting maximum rates that exceed the

[41] Order No. 637 at 31,274 (*quoting* M. Barcella, How Commodity Markets Drive Gas Pipeline Values, Public Utilities Fortnightly, February 1, 1998 at 24-25).

[42] Gulf South comments at 17.

basis differentials, the Commission could force whatever reductions in the delivered price of gas the market requires to be made with respect to the commodity component, rather than the transportation component of the delivered price. For example, IMGA states that, without discounts, wellhead prices may fall somewhat. However, the Commission believes that any effort to insulate one component of a price from market forces would cause harmful distortions and ultimately fail.

45. IMGA and Northern Municipals contend that, in today's market, with its higher natural gas commodity prices, there is no need to be concerned that unavailability of discounts to the basis differentials could lower producer net backs. They argue that, if no discount is granted, the producer will either adjust its price to clear this market, or will choose to flow its gas to some other market where a consumer is willing to pay more, a correct result in a competitive market. Also, Northern Municipals suggest that, given the deregulation of wellhead prices, the Commission should no longer be concerned with the effect of interstate transportation rates on producers.

46. However, as already discussed, when Congress deregulated wellhead prices in 1989, it directed that the Commission exercise its remaining NGA jurisdiction over transportation in manner that would improve the competitive structure of the natural gas market. In response to that directive, the Commission has consistently taken into account the effect of its rate policies on natural gas production, most significantly when it adopted the straight fixed variable (SFV) rate design for firm transportation rates in Order No. 636. The purpose of that policy was to minimize the distorting effect of transportation costs on producer decisions concerning exploration and production. As the Commission stated in the May 31 Order, the various interstate pipelines competing in the same downstream markets generally bring gas from different supply basins. For example, different interstate pipelines serving California are attached to supply basins in the Texas, Oklahoma, Gulf Coast area; the Rocky Mountain area, and Canada. Given the differences between pipeline maximum rates based on their differing historical costs and given the fact that market value of transportation between two points is at times less than the pipeline maximum rates, any effort by the Commission to insulate pipelines from market forces would be inconsistent with the Congress's directive that the Commission seek to improve the competitive structure of the natural gas market. Without discounts by the higher cost pipelines, producers in supply basins served by higher cost pipelines would generally face the burden of any price reductions necessary to meet the market price for delivered gas in the downstream areas.[43] As a result, gas reserves from supply areas served by lower cost pipelines would have a built-in cost advantage over gas reserves served by higher cost pipelines.

[43] Reliant Energy at 11; Gulf South at 30.

47. IMGA and Northern Municipals also contend that the Commission's statement that discounts help interstate pipelines with higher cost structures to compete with lower cost pipelines, enabling the capacity for both pipelines to be utilized in the most efficient manner possible, provides no support for the selective discounting policy. However, it is clear that in such a situation the pipeline with the higher maximum rate may need to discount to compete with the pipeline with the lower maximum rate to the extent the pipeline with the lower maximum rate has available capacity. Discouraging the pipeline with the higher maximum rate from discounting in that situation would only harm that pipeline's captive customers, since it would lose throughput over which it could otherwise spread its fixed costs. IMGA and Northern Municipals suggest that such discounts would provide no overall public benefit, since they would not increase overall throughput on both interstate pipelines. Rather such discounts would only serve to switch throughput from one pipeline to the other. However, the Commission finds there is a clear public benefit to maximizing the ability of higher cost pipelines to compete with lower cost pipelines. Otherwise, the higher cost pipeline will tend always to lose throughput over which to spread its fixed costs, thus exacerbating the difference in rates between the two pipelines making it more and more difficult for the higher cost pipeline to compete and leading the captive customers of the higher cost pipeline to bearing an inequitably high transportation cost vis-à-vis the captive customers of the lower cost pipeline.[44]

48. Indeed, discounting has become an integral part of today's dynamic natural gas market.[45] The U.S. natural gas pipeline grid has become increasingly interconnected since the transition to unbundled, open access transportation service pursuant to Order Nos. 436, 636, and 637, with pipeline companies making substantial investments in constructing new pipeline facilities. In response to a 2005 INGAA survey, 36 pipelines reported that they had spent $19.6 billion for interstate pipeline infrastructure between 1993 and 2004, and during the 1990s interregional natural gas pipeline capacity grew by 27 percent.[46] As a result, most major markets are now served by multiple interstate pipelines. For example, customers in the Chicago metropolitan area are served by eleven interstate pipelines, giving them access to natural gas supplies in Western Canada, the Rocky Mountains, New Mexico, Oklahoma, Michigan, Louisiana, the Gulf coast, and

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[44] See Michigan Consolidated Gas Co. comments at 4-5, describing the adverse effect on TransCanada Pipeline and its customers due to its inability to discount in competition with the United States pipelines; Transco comments at 9-10.

[45] INGAA comments at 7-10; Duke comments at 18-22; Transco comments at 5-8, 27-28; Process Gas comments at 3-4; Gulf South comments at 10, 11, 17-19; Dominion Resources comments at 3-5; NGSA comments at 8-10.

[46] INGAA comments at 9.

Texas.[47] In this environment, gas-on-gas competition and alternate fuel competition are interchangeable. Discounts given by competing pipelines also serve to increase the market share of natural gas versus alternate fuels.[48]

49. In their rehearing requests, IMGA and Northern Municipals contend that, whatever public benefits may arise from discounts given by one interstate pipeline to meet competition from another interstate pipeline, captive customers should not have to bear the cost of those discounts through a discount adjustment to rate design volumes. They contend that the Commission erred when it found that such discounts benefit captive customers, since the customers receiving such discounts are demand elastic and therefore those discounts help increase overall throughput on interstate pipelines.

50. In their rehearing requests, IMGA and Northern Municipals do not seriously contest the Commission's finding that such discounts will increase the demand of the customers receiving them in at least some of the ways found by the Commission. For example, the Commission stated that industrial and other business customers of pipelines typically face considerable competition in their own markets and must keep their costs down in order to prosper. Lower energy costs achieved through obtaining discounted pipeline capacity can help industrial and other business customers of pipelines, who typically face considerable competition in their own markets, do more business than they otherwise would, thereby increasing their demand for gas. Also, such discounts may reduce the incentive for existing non-fuel switchable customers to install the necessary equipment to become fuel switchable. In addition, potential new customers, such as companies considering the construction of gas-fired electric generators, may be more likely to build such generators if they obtain discounted capacity on the pipeline.

51. However, the thrust of IMGA and Northern Municipals' argument is that the Commission has not shown that such increased demand will translate into increased overall throughput or revenues on interstate pipelines. IMGA contends that a study presented by INGAA in its comments shows that the demand elasticity in the natural gas transportation market is very limited, with the result that, for every 10 percent decrease in the price of transportation, demand for transportation increases by only about 1.2 percent.[49] IMGA contends that, as a result, any additional revenues generated by a pipeline decreasing its rates through discounts in competition with another pipeline will

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[47] Kinder Morgan comments at 10.

[48] Kinder Morgan comments at 7, 18.

[49] IMGA cites pages 14-15 of an affidavit by Bruce B. Henning attached to INGAA's comments.

not offset the effects of the rate decreases.[50] IMGA also argues that even if a discounted rate given to customers with access to more than one pipeline would cause them to increase their consumption of natural gas, the increased price that the discount adjustment would charge to captive shippers would cause them to decrease their consumption by a similar amount. IMGA states that this is because the difference between captive customers and discounted shippers is not the elasticity of their demand, but whether there are alternative pipelines from which they can purchase.

52. Similarly, Northern Municipals state that the Commission makes conclusory statements that overall throughput on the national grid will increase as a result of discounting, but provides no studies or evidence to back this up. Similarly, Northern Municipals argue that unless the reduction in fixed costs to captive and other customers is greater than the discounts they are forced to absorb, the increase in throughput does nothing to protect the interests of captive customers and, they allege, there is no solid evidence to support the conclusion that any increase in throughput will result in a net decrease in rates to consumers. Northern Municipals states that the May 31 Order provides no support for the presumption that increased throughput results in more spreading of fixed costs, thus benefiting consumers that are not entitled to discounts by providing them with lower overall rates. They state that the only thing the order proves is that if a rate is discounted heavily enough, it may attract some additional volumes. But, they argue, if the discount the ratepayers must absorb is greater than the offsetting reduction in the portion of the fixed costs that those ratepayers must bear, there is no justification for the discount.

53. The Commission recognizes that the discounts a pipeline gives in competition with another interstate pipeline may or may not increase the overall revenue collected by interstate pipelines. As discussed below, the revenue effects of particular gas-on-gas discounts given by a pipeline depend on the circumstances in which the pipeline gave the discount. However, the Commission's experience has been that such discounts generally do not cause significant cost shifts to captive customers. Therefore, the Commission reaffirms its conclusion that discounts given by competing pipelines provide sufficient public benefits that we will not modify our policy to adopt a blanket prohibition on adjustments to rate design volumes to reflect such discounts. As we stated in the May 31 Order, if there are circumstances on a particular pipeline that warrant additional protections for captive customers, including a limitation on the discount adjustment to rate design volumes, those issues can be considered in individual rate cases.

[50] IMGA illustrates its contention with the following example: It assumes a pipeline with revenues of $250.00 based on charging $.50 per Mcf for throughput of 500 Mcf. If the pipeline reduced its rate by 10 percent to $.45 per Mcf in order to increase its throughput by 1.2 percent to 506 Mcf, it would then generate revenues of $227.70, about 9 percent less than its revenues without the rate reduction.

54. IMGA and Northern Municipals assume that, where two pipelines compete with one another they will engage in a destructive bidding war, with the result that all customers with access to the two pipelines will receive heavily discounted rates for all their service without regard to their elasticity of demand. However, this assumes that in such a situation the customers with access to the two pipelines will have all the bargaining power, and the two pipelines will have none. This is unlikely to be the case. If the total capacity of the two pipelines is not greatly in excess of the demand for transportation service in the markets served by the two pipelines, competition between the customers for the pipelines' capacity should give the pipelines some ability to minimize any discounts and target the discounts they do give to the customers whose demand will increase with a lower rate so as to fill the pipeline.

55. Moreover, pipelines have an incentive not to discount too deeply, because they recognize that, to the extent they do file a rate case to attempt to raise rates to their remaining customers, the demand of those customers could go down. Also, those customers would then have more of an incentive to seek alternatives of their own, for example through participating in the expansion of another pipeline. The affidavit of Bruce Henning, submitted by INGAA and relied on by IMGA, pointed out that long-run elasticities of demand are always higher than short-term demand elasticities, usually two to three times.[51] That is because in the long-run consumers can make capital investments to increase price responsiveness, including investments to increase their efficiency, and their alternative fuel capacity. In addition, the pipelines should recognize that the Commission has stated that it may not permit a full discount adjustment in situations where that would lead to an inequitable result.[52]

56. There is nothing in the record developed in response to the NOI to suggest that the Commission's general policy of permitting pipelines to propose discount adjustments for gas-on-gas competition has led to a widespread cost shift to captive customers. The NOI asked the commenters for specific examples of rate cases where the discount adjustment has impacted captive customers. No party was able to point to any rate case where discounts due to gas-on-gas competition actually caused a substantial cost shift to captive customers. In response, IMGA referred to discounts in Docket No. RP95-326, *Natural Gas Pipeline Co. of America*, where, IMGA asserts, discounts produced adjustments in throughput that resulted in rates so high that Natural chose not to increase their tariff rates as much as could have been justified. IMGA also referred to *Southern Natural Gas*

[51] Henning Affidavit at 15.

[52] *See Natural Gas Pipeline Company of America*, 73 FERC ¶ 61,050 at 61,128-29 (1995), and *El Paso Natural Gas Co.*, 72 FERC ¶ 61,083 at 61,441 (1995).

Co.,[53] where it had submitted testimony concerning discounts given by Southern during the period May 1992 through April 1993. Northern Municipals referred to the discount given to CenterPoint on Northern.

57. These specific Commission proceedings cited by the parties seeking rehearing do not support a finding that gas-on gas discount adjustments have caused a significant cost shift to captive customers, requiring a drastic policy change seeking to discourage such discounts. Instead, they support the conclusion that individual rate cases provide the appropriate forum for determining the extent to which a discount adjustment for this type of discount is just and reasonable in the circumstances of the particular case. As IMGA points out, in the *Natural* decision, the circumstances resulted in the pipeline not implementing the full discount adjustment. Indeed, in its rehearing request,[54] IMGA recognizes that Natural, and a second pipeline which faces substantial gas-on-gas competition, Gulf South Pipeline Company, have been able to engage in effective and efficient competition. As a result, they have not had to shift large amounts of costs to captive customers through discount adjustments. IMGA also recognizes that one factor in the ability of these pipelines to successfully compete has been the Commission's 1996 policy of permitting pipelines to negotiate rates using a different rate design from their recourse rates.[55]

58. In the *Southern* decision cited by IMGA, the parties reached a settlement. Moreover, in the May 31 Order the Commission found that the testimony presented in that case concerning discounting practices of one interstate pipeline over ten years ago are not probative of the prevalence of gas-on-gas discounting by all interstate pipelines today,[56] and IMGA does not contest that finding in its rehearing request. As discussed more fully below, the issue of whether Northern should receive a full discount adjustment in connection with the CenterPoint discount has not been decided and parties will have an opportunity to address all the relevant facts concerning this discount in Northern’s next rate case.

59. Thus, appropriate actions have been taken in individual rate cases to resolve this issue. In the individual rate cases, parties can investigate the specific facts surrounding

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[53] 65 FERC ¶ 61,348 (1993).

[54] IMGA rehearing at 20.

[55] *Alternatives to Traditional Cost-of-Service Ratemaking*, 74 FERC ¶ 61,076 (1996).

[56] 111 FERC ¶ 61,309 at P 20.

the discount to determine whether a full discount adjustment is warranted and whether any special circumstances require additional protections for captive customers. This approach retains the competitive benefits of discounting and at the same time allows the Commission to take action to mitigate the impact of a discount adjustment if the circumstances require.

60. Thus, the Commission finds that the responses to the NOI produced no evidence to support IMGA's allegation in its brief to the D.C. Circuit on the appeal of Order No. 637 that the discount adjustment for gas-on-gas competition has burdened captive customers by a cost "tilt of billions of dollars of costs."[57] As a result, the Commission concludes that a continuation of its current general policy permitting pipelines to seek discount adjustments for gas-on-gas discounts in individual section 4 rate cases, with the ability to consider limits on a case-by-case basis, strikes the best balance between enabling the industry to obtain the benefits of such discounting discussed above, while minimizing the potential ill effects. Thus, the Commission rejects the request of IMGA and Northern Municipals that it establish a blanket rule prohibiting pipelines from proposing such a discount adjustment in a section 4 rate case.

61. In its rehearing request, Northern Municipals contends that, even if the Commission does not prohibit discount adjustments for discounts given in competition with another pipeline, the Commission should require pipelines to demonstrate in their initial rate filing that such discounts actually increased throughput sufficiently that the proposed rates are lower than they would have been had no discount been granted. Under current Commission policy, the Commission gives shippers a full opportunity to litigate all issues concerning the justness and reasonableness of any proposed discount adjustment. While the Commission does not require pipelines in their initial rate filing to include evidence justifying why competition required each and every test period discount underlying the pipeline's proposed discount adjustment, the customers have the ability through discovery in the rate case to inquire into why the pipeline provided each such discount. In their rehearing requests, IMGA and the Northern Municipals seek to portray the Commission's presumption that discounts given to non-affiliates were required by competition as an insuperable obstacle to contesting the need for any such discounts. However, as the Commission clarifies elsewhere in this order that is not a correct interpretation of our policy. To the extent a pipeline is unable during the discovery process to explain what competitive alternatives the recipient of any particular discount had or otherwise give a satisfactory explanation of why the discount was required, that fact by itself would be sufficient to rebut the presumption that competition required the discount.

[57] INGAA v. FERC, 285 F.3d 18, 58 (D.C. Cir. 2002).

62. Moreover, as indicated by the Commission's orders in *Natural*[58] and *El Paso*,[59] even where a pipeline is able to show that particular discounts were required to meet competition from another pipeline, parties may argue that the competition between the two pipelines led to such deep discounts that a full discount adjustment would lead to an inequitable cost shift to the captive customers. As the Commission stated in the May 31 Order, the Commission continues to be mindful of its obligations to captive customers and will consider the impact of any discount adjustment on those customers in specific proceedings. In this regard, the Commission notes that Northern Municipals in its rehearing request has contended that certain discounts Northern has recently provided to two large LDCs will lead to an improper cost shift in Northern's next rate case. However, as the Commission has stated in its orders concerning those discounted rate transactions, if Northern proposes in its next rate case a discount adjustment based on those discounted rate transactions, the parties may litigate all issues concerning the justness and reasonableness of any such discount adjustment.

63. Finally, Northern Municipals refer to an example provided in the initial comments of the Commission's Office of Administrative Litigation (OAL) and assert that the Commission did not adequately refute the conclusion drawn from this example that overall throughput is not increased when a selective discount is given to meet gas-on-gas competition. We will restate that example here:

> Assume that an LDC is attached to three pipelines, Pipelines A, B, and C, each with their own contracts to transport 20,000 MMbtu/day. If the LDC's contract with Pipeline A is set to expire at the end of Year 1, the LDC will negotiate with all three pipelines to obtain the best price for the desired capacity. If Pipeline B offers the best discounted price, Pipeline A will have lost the contract. If the loss of volumes is sufficient Pipeline A will file a rate case, and receive an increase in rates, based on the reduced throughput of the lost LDC contract. All captive customers of Pipeline A will pay higher maximum rates.
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> Meanwhile, Pipeline B will have increased its throughput by 20,000 MMbtu/day. All other things being equal, since Pipeline B's volumes now exceed those upon which its rates were designed by 20,000 MMbtu/day, the additional volumes will simply increase Pipeline B's earned rate of return until such time as the pipeline files a rate case.

[58] 73 FERC ¶ 61,050 (1995).

[59] 72 FERC ¶ 61,083 (1995).

> If, during of Year 2, the LDC's original contract with Pipeline B (a maximum rate contract for a different 20,000 MMbtu/day) expires, the pipelines again can bid for the capacity and offer discounts. If Pipeline C wins the contract, Pipeline B's overall throughput will decrease back down to the level it was at before it acquired the volumes from Pipeline A. Now, however, Pipeline B may have to file for a rate increase because, even though it is selling the same volumes upon which its rates were designed, 20,000 MMbtu/day of those volumes (*i.e.*, the volumes it took from Pipeline A which it still has) now move at a discounted rate. As a result, Pipeline B will show a revenue shortfall, and it will be given a discount adjustment for the discounted rate it is receiving from the LDC for the capacity it acquired that originally was under contract with Pipeline A.
>
> If, during Year 3, Pipeline C's original contract with the LDC expires, the pipelines again can bid for the capacity and offer discounts. If Pipeline C wins the contract again, but at a steep discount, it may have to file for a rate increase as its revenues may be short of its costs even though it has increased its throughput volumes.

64. Northern Municipals state that three conclusions can be drawn from this hypothetical: First, the LDC did not change the total amount of gas it transported and consumed. Second, two of the three pipelines were able to increase their earned rates of return for a period of time due to the excess volumes captured from the pipeline holding the original contract. Third, maximum rates to captive customers left on the LDC's original pipeline experienced an increase in rates due to the LDC's defection, and eventually, captive customers on the other pipelines also experienced an increase. Northern Municipals state that all this occurred with no increase in net throughput. Thus, they conclude, the final result is that the LDC and its customers enjoy lower rates, but the captive maximum rate and other customers pay higher rates with no corresponding benefits and, thus, subsidize the discount to the LDC.

65. There are several problems with this overly simple example, which was clearly developed to prove the result that it assumes. In the first place, the example assumes that both Pipeline B and Pipeline C have 20,000 MMBtu/day of unsubscribed capacity that is available for sale to the LDC. The example does not, however, explain how those units of unsubscribed capacity were accounted for in Pipeline B and C revenue requirement or the cost impact of the unsubscribed capacity on the current customers. If those costs are not being collected by Pipeline B and C, its customers will be better off if the pipeline sells its unsubscribed capacity at a discount, rather than if it files a rate case to recover the costs of the unsubscribed capacity from its current customers. The discounts will protect the captive customers from absorbing the full costs of the unsubscribed capacity. The example also assumes that if Pipeline A loses 20,000 MMBtu/d, it will file a rate case and the Commission will allow it to shift all the costs of its unsubscribed capacity to its

captive shippers. Neither of these of scenarios may occur. Pipeline A would likely try to resell this capacity and, if Pipeline A did file a rate case, the Commission might not allow the recovery of all of the costs of the unsubscribed capacity from the captive customers. In any event, Northern Municipals does not cite any case or real-life example where anything like this occurred.

66. As discussed above, the Commission understands that there may be circumstances where gas-on-gas competition could result in discounts and no increase in throughput. However, this example cited by Northern Municipals provides no basis for making any changes in the Commission's current policy.

2. Competition From Capacity Release

67. In the May 31 Order, the Commission found that there was no basis for creating an exemption from the selective discounting policy for discounts that result from competition from capacity release. The Commission explained that its goal in creating the capacity release market in Order No. 636 was to create a robust competitive secondary market for capacity, and stated that the capacity release program, together with the Commission's policies on segmentation and flexible point rights has been successful in achieving this goal. The Commission stated that to prevent pipelines from competing effectively in this market would defeat the purpose of capacity release and eliminate the competition that capacity release has created. The Commission also explained that capacity release benefits captive customers by allowing them to compete with pipelines for their unused capacity, and this provides them with an opportunity to offset a portion of their transportation costs. The Commission stated that it is not unreasonable to require shippers to compete with the pipeline for the sale of released capacity. In addition, the Commission stated that releasing customers have some competitive advantages over the pipelines in the capacity release market. Thus, the Commission explained that flexible point rights and the ability to segment capacity enhance their ability to compete in the secondary market, and that shippers have an additional advantage in the secondary market because the capacity that is being released by the shippers is firm capacity, while the pipeline may be limited to selling service on an interruptible basis because it has already sold the capacity to the releasing shipper on a firm basis. Northern Municipals and IMGA seek rehearing of the Commission's ruling on this issue.

68. Northern Municipals state that capacity release is based on a fundamentally different concept than the selective discounting policy. They assert that the capacity release program is intended to enable firm customers of pipelines to sell any excess firm capacity and thereby recoup some of the costs associated with holding that firm entitlement. Order No. 637 was also intended to benefit captive customers, Northern Municipals argue, by reducing their revenue responsibility through a combination of increased capacity release revenues, revenue credits, reduced discount adjustments, and

lower long-term rates on pipelines instituting peak/off peak or term differentiated rates. On the other hand, Northern Municipals state, the selective discount policy is premised on the belief that discounting increases throughput on the overall national grid to the benefit of captive customers. Northern Municipals argue that allowing pipelines to use selective discounting to compete with their own firm capacity holders is at odds with the general goals of the capacity release program, as well as the goals of Order No. 637.

69. Northern Municipals are correct that the selective discount policy and the capacity release programs are based on fundamentally different concepts. The Commission discussed the differences in the development of these policies in the NOI in this proceeding[60] as well as in its order in *Williston Basin Interstate Pipeline Co.*[61] As the Commission explained, the selective discount policy was adopted as part of Order No. 436 and is based on a monopolistic model, while the capacity release program was adopted in Order No. 636, where the Commission began to move away from the monopolistic selective discount model to a more competitive model, especially for the secondary market. In Order No. 636, the Commission adopted significant changes to the structure of the services provided by natural gas pipelines in order to foster greater competition in the natural gas markets.

70. One of these changes was the adoption of the capacity release program. As Northern Municipals state, one of the purposes of the capacity release program was to enable customers to sell their unused capacity in the secondary market and thus mitigate the shift to the SFV rate design. However, this was not the only or the primary purpose of the capacity release program. As the Commission explained in Order No. 636-A, the capacity release mechanism is intended to create a robust secondary market where the pipeline's direct sale of its capacity must compete with its firm shippers' offers to release their capacity. The Commission stated that this competition would help ensure that customers pay only the competitive price for the available capacity.[62] In upholding the capacity release program in *UDC v. FERC*,[63] the court recognized that capacity release is intended to develop an active secondary market with holders of unutilized firm capacity rights reselling those rights in competition with capacity offered directly by the pipeline.

71. The issue therefore is how best to accommodate the policies behind selective discounting and capacity release. The Commission believes that the May 31 Order

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[60] See NOI at P 2-6.

[61] 107 FERC ¶ 61,229 at P 3-9 (2004).

[62] See Order No. 636-A, FERC Stats. & Regs. at 30,553 and 30,556.

[63] 88 F.3d 1105, 1149 (D. C. Cir. 1996).

strikes the appropriate balance. Northern Municipals and IMGA would have the Commission focus only on the goal of allowing captive customers to recoup some of their transportation costs. But, the capacity release program, as upheld by the court in *UDC v. FERC*, was also intended to create a robust competitive secondary market. It was not the intent of the Commission to allow customers to release capacity without competition between the customers and the pipelines, and it was entirely reasonable for the Commission to require customers to compete with the pipelines in these circumstances. The Commission always intended that customers would be required to compete with pipelines for the sale of this capacity and to protect customers from this competition would negate and equally important part of the capacity release policy.

72. The Commission must adopt policies of general application that promote the Commission's goals in the national gas market. Competition in the secondary market benefits all users of the system. Reduction of incentives for pipelines to offer discounts would reduce competition. The public interest is best served when the Commission's policies promote competition and market efficiency to the maximum practical extent. The Commission's policies on capacity release and pipeline discount adjustments act together to maximize competition and economic efficiency, resulting in lower delivered energy prices for consumers in aggregate. Denying pipelines a discount adjustment for capacity sold below the maximum rate in competition its customers would inhibit the competitive market that capacity release has created.

73. Further, Northern Municipals argue that the Commission has not demonstrated how the goal of increasing throughput on the national grid and, thus, spreading fixed costs over more units of service, is furthered by allowing discount adjustments for capacity sold by an interstate pipeline in competition with released capacity. In these circumstances, Northern Municipals argue, the pipeline is merely competing to resell the same capacity that has already been sold to the releasing shipper as firm capacity. Northern Municipals state that the fixed costs associated with this capacity have already been paid, and, therefore the charge paid for this capacity will not add to the recovery of fixed costs. Further, Northern Municipals argue, the impact on throughput will be the same whether the pipeline sells this capacity or the releasing shipper sells this capacity.

74. Northern Municipals' argument misunderstands how increased throughput on the pipeline impacts the reservation charges of firm customers. Increased capacity sold by the pipeline, in competition with capacity release or otherwise, will not impact the *current* reservation charges paid by firm customers, but will reduce those charges *in the next rate case*. In a rate case, rates are determined by dividing the revenue requirement by the units of throughput. The higher the throughput, the lower the rates and, thus, if the pipeline's throughput during the rate case test period is increased due to discounting the reservation charges in the next rate case will be lower than they would have been without the increased throughput. If firm shippers release capacity in competition with the pipeline and a replacement shipper buys the capacity from the shipper instead of the

pipeline, then there will be no increase in the pipeline's throughput from that transaction to reduce rates in the next proceeding. But, the releasing shipper has instead received an immediate and direct benefit by making the sale of capacity and thereby recovered some of its reservation charges. When the Commission implemented Order No. 636, it recognized that competition from capacity release would reduce the amount of interruptible transportation service the pipelines would be able to sell. Therefore, in the Order No. 636 restructuring proceedings of individual pipelines, the Commission permitted the pipelines to reduce their allocation of costs to interruptible service. However, the Commission determined then, and reaffirms now, that enabling firm shippers to release their capacity when they are not using it and immediately recover some of their reservation charges provides a greater benefit that more than offsets the cost of any reduced allocation of fixed costs to interruptible service.

75. In addition, Northern Municipals dispute the Commission's conclusion that the releasing shipper has a competitive advantage over the pipeline and states that circumstances on Northern give it some advantages over the releasing shipper. First, Northern Municipals state, Northern offers a daily firm service which may be more attractive to shippers than released capacity. Further, Northern Municipals assert, Northern has a competitive advantage over releasing shippers in terms of price because during the summer months there is excess capacity on Northern and the price for this capacity is very low. In addition, Northern Municipals assert, Northern may enter into contracts that exempt shippers from surcharges, giving Northern a price advantage over a releasing firm shipper that is subject to these charges. Northern Municipals state that Northern can undercut the releasing shipper by this amount without absorbing any costs, and then turn around and propose a selective discount adjustment that raises the rates of the shipper against whom Northern was competing to sell the capacity. Northern Municipals state that these advantages are not the result of a competitive market, but are instead the result of Northern's ability to use its monopoly power to manipulate rates in a manner that maximizes its revenues, contrary to the fundamental notion that interstate pipelines should not be permitted to use their market power to the detriment of their customers.[64]

76. Nothing in Northern Municipals' argument negates the fact that Order No. 637's policies on segmentation and flexible point rights enhance a shipper's ability to compete in the secondary market. Moreover, since the shippers have contracted for guaranteed firm service for the entire term of their contracts, they can release guaranteed firm service for whatever term they do not require the service themselves. This does give them the ability to sell a high quality service in the secondary market, rather than the short-term

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[64] Northern Municipals cites *UMDG v. FERC*, 88 F.3d 1105, 1127 (D.C.Cir. 1996).

daily firm service described by Northern Municipals. It may be that Northern has some advantages as well, but this has not hampered competition in the secondary market. The Commission's policies have led to an active and competitive secondary market for the sale of capacity.

77. Northern Municipals and IMGA argue that a discount adjustment for discounts given in competition with capacity release amounts to a subsidy and that therefore captive and other firm shippers are required to subsidize the very discounts that kept them from selling their excess capacity. IMGA argues that the Commission's citation to *AGD I*[65] as justification for the discount adjustment is inapposite because the Commission's current discount policy with the discount adjustment was not before the court and thus any statement regarding the discount adjustment was dicta.[66] Moreover, IMGA asserts, *AGD I* also made clear that the "opportunity to recover costs does not guarantee that those costs are recoverable in the face of competition."[67] Thus, IMGA states, if captive customers' rates are increased to offset the loss the pipeline would otherwise incur in discounting in competition with capacity release, those discounts are subsidized, and, unless there is evidence that captive customers benefit from the subsidy, it is unlawful.

78. Contrary to the suggestion of IMGA and Northern Municipals the discount adjustment is not a subsidy. Pipelines are not, as IMGA and Northern Municipals suggest, reimbursed for the discount by the captive customers through the discount adjustment and the discount adjustment should not raise the rates of captive shippers. As explained above, in a rate case, the rates going forward are determined by dividing the pipeline's projected costs by its projected future throughput on the volumes transported during the rate case test period. If some of the test period volumes were transported at a discount, the discount adjustment recognizes that these volumes were transported at less than the maximum rate. Therefore the units of throughput for ratemaking purposes are reduced to reflect the discounting.

79. To the extent that a discount adjustment for discounts given to interruptible customers in competition with firm customer capacity release results in a higher allocation of costs to firm services, as opposed to interruptible services, that allocation

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[65] *A GD I at* 1012.

[66] IMGA states that the D.C. Circuit made this clear in *Mississippi Valley Gas Co. v. FERC*, 68 F.3d 503, 506-07 (D.C. Cir. 1995); *Transcontinental Gas Pipe Line Corp. v. FERC,* 998 F.2d 1313, 1318, 1321 (D.C. Cir. 1993); *Columbia Gas Transmission Corp. v. FERC*, 848 F2d 250, 251-254 (D.C. Cir. 1988).

[67] IMGA cites *AGD I* at 1001.

appropriately recognizes that firm service with the right to release capacity in competition with the pipeline and the right to segment and use flexible point rights is a higher quality service with substantial rights.

80. Further, while it is true that the discount adjustment was not before the court in *AGD I*, the court clearly indicated its concern that the absence of a discount adjustment would be a “dubious” practice that could result in denying the pipelines and opportunity to recover their costs. It was not error for the Commission to respond to the court’s concern in further developing its discount policy.

81. Of course, if there were no discount adjustment and all of the discounted volumes were included in the test period throughput as though they had been transported at the maximum rate, the rate derived using those volumes would be lower than the rates that would be derived using the discount adjustment. But, if the Commission required pipelines to include the full amount of all volumes transported at a discount, then, as the court pointed out in *AGD I*, the pipeline would be in jeopardy of not having an opportunity to recover its cost of service. This would discourage discounting. In these circumstances, it is likely that the pipeline would not have transported the volumes at the discounted rate and the throughput in the next rate case would be lower than if the volumes had been transported at a discount.

82. Further, IMGA argues that discounting in competition with capacity release does not benefit captive customers and therefore the policy cannot be continued. First, IMGA states, small captive customers on one-part rate schedules are not permitted to release capacity and, second, even if a captive customer benefits from capacity release, that does not mean that it benefits from discounting in competition with capacity release.

83. Again, IMGA’s focus is too narrow. The Commission recognizes its obligation to protect captive customers from the monopoly power of the pipelines, but the Commission has other obligations as well and must balance a number of interests in developing its policies. Captive customers might be better off if they were able to sell their capacity in the capacity release market without competition from the pipelines, but this would defeat the Commission’s purpose in adopting the capacity release program to develop a robust competitive secondary market for capacity. It is not unreasonable for the Commission to require firm shippers to compete with pipelines for the sale of capacity in the secondary market.

84. As the Commission explained in Order No. 636-B, [68] because customers paying a one-part[69] rate do not pay a reservation charge to reserve capacity, they cannot release that capacity. However, the Commission also stated that the pipeline should develop procedures that would enable customers served under one-part rate schedule to convert to a two-part rate schedule if they choose to convert in order to release capacity. Presumably, IMGA's one-part rate shippers could convert to a two-part rate schedule if they choose to take advantage of the benefits of capacity release. The one-part volumetric rate with an imputed load factor paid by small customers is a subsidized rate that provides them with a lower rate than they would pay if they paid the rate applicable to larger shippers. The choice is for the small shipper to decide if it prefers the benefits of its lower one-part rate to the benefits of capacity release.

3. Competition From Intrastate Pipelines

85. In the May 31 Order, the Commission stated that competition from intrastate pipelines is not subject to the Commission's jurisdiction and the Commission therefore has no ability to discourage intrastate pipelines from offering discounts in competition with interstate pipelines. Therefore, the Commission stated that interstate pipeline discounts to avoid loss of throughput to non-jurisdictional intrastate pipelines do benefit captive customers of the interstate pipelines. The Commission stated that the commenters opposing the discount adjustment seemed to recognize this and therefore focused their comments on competition from interstate pipelines and capacity release.

86. On rehearing, Northern Municipals argue that the Commission has provided no support for its statement that customers benefit from discounts given to avoid loss of throughput to intrastate pipelines. Northern Municipals assert that the analysis of whether a discount given to meet competition from an intrastate pipeline is no different from the analysis that should apply to a discount given to meet competition from an interstate pipeline, *i.e.*, does the discount that shippers are being asked to bear outweigh any benefits from retaining the load in question. Northern Municipals assert that competition from an intrastate pipeline will almost always involve competition from another interstate pipeline and that they believe that the majority of intrastate pipelines are not built to allow a shipper to directly access a production area, but instead are built to provide access to another interstate pipeline. Thus, they argue, the analysis is not different than if a shipper went directly to the competing interstate pipeline.

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[68] Order No. 636-B, 61 FERC ¶ 61,272 at 61,998 (1992).

[69] As the Commission explained in the May 31 Order, small captive customers pay one-part volumetric rates on many pipelines. Small shippers paying these one-part rates do not pay a reservation charge to reserve capacity and their rates are often developed using an imputed load factor that is higher than the customer's actual use of the system.

87. Northern Municipals give as an example the discount given by Northern to CenterPoint. Northern Municipals state that the discount granted to CenterPoint was for capacity that CenterPoint already had under contract and therefore no increase in throughput would result from the CenterPoint deal either on Northern or on the interstate grid. Northern Municipals state that the competition in this case was from an intrastate pipeline and that CenterPoint's competitive alternative was to build or have built an intrastate pipeline to access another interstate pipeline, not to access directly the production area. Northern Municipals further state that while the Commission has assured Northern Municipals that it can attack this discount in a future rate case, the Commission's statement that discounts given to meet competition from intrastate pipelines do benefit captive customers of the interstate pipeline prejudges that issue.

88. Parties did not generally argue in their initial comments that discounts to meet competition from intrastate pipelines would not increase throughput on the national transportation grid, as they did with regard to discounts given to meet competition from other interstate pipelines. Therefore, the May 31 Order did not focus on this issue. The Commission lacks jurisdiction over intrastate pipelines and thus cannot discourage them from discounting through its ratemaking policies. Therefore, interstate pipelines must be allowed to compete with intrastate pipelines or throughput will be lost to the intrastate pipelines to the detriment of the interstate customers.

89. If an interstate pipeline gives a shipper a discount in order to keep that shipper on the system, the discount benefits the captive customers of the pipeline by retaining that throughput. If instead the volumes left the system to be transported on an intrastate pipeline, the overall volume on the interstate system would be lower as a result. If the volumes were retained on the interstate pipeline rather than moving via an intrastate pipeline to another interstate pipeline, the issues would be similar to those discussed above with regard to competition between interstate pipelines. As the Commission has concluded above, competition between interstate pipelines can increase throughput on the interstate grid and can produce additional benefits to users of the system. Thus, the Commission has concluded that in either case a discount to gain or retain throughput may be appropriate if the pipeline is able to show that the discount was necessary to meet competition.

90. In any event, the issue of whether the discount given to CenterPoint should receive a discount adjustment under the Commission's policy can be addressed in the rate case where Northern seeks a discount adjustment. Northern Municipals raised issues concerning the CenterPoint discount when Northern filed its service agreement with CenterPoint for the Commission to approve various material deviations in the service

agreement. As the Commission's March 23, 2005[70] and June 8, 2005[71] Orders in that proceeding made clear, the Commission has made no determination as to whether Northern will be able to obtain a discount adjustment in its next rate case for the discount given to CenterPoint, and neither does anything in this order prejudge that issue. Similarly, as the Commission explained in the November 1, 2005 Order in *Northern Natural Gas Co.,*[72] the issue of whether Northern will be permitted to adjust its rate design volumes in its next rate case to reflect discounts given to another Northern customer (Metropolitan Utilities District) will be decided in that next rate case. The issue of whether any other equitable relief would be appropriate in the circumstances of these discounts can also be addressed in the next rate case.

91. Thus, as a general rule, a discount granted by an interstate pipeline to meet competition from an intrastate pipeline will result in greater throughput on the interstate system than without such a discount to the benefit of all customers. If there are special circumstances that the Commission should consider, it can do so in an individual rate case.

E. The Discount Adjustment for Discounts Given on Expansion Capacity

92. In the May 31 Order, the Commission found there was no reason to create an exemption from the selective discounting policy for expansion projects. The Commission explained that new construction is no longer undertaken solely for the purpose of serving new markets, but also to provide natural gas customers with competitive alternatives to existing service. The Commission stated that, as a result of recent expansions, there are fewer captive customers,[73] and policies that encourage these expansions will provide more options to customers that are currently captive and thus enable them to benefit from the competitive markets. However, the Commission also clarified that in receiving approval for the expansion project, the pipeline must meet the

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[70] *Northern Natural Gas Co.,* 110 FERC ¶ 61,321 at P 32 (2005).

[71] *Northern Natural Gas Co.,*111 FERC ¶ 61,379 at P 8 (2005).

[72] 113 FERC ¶ 61,119 (2005).

[73] INGAA states that since the implementation of the Order No. 636, substantial new capacity has been built, leading to more gas-on-gas competition and thus fewer captive customers. INGAA states that the 36 pipeline companies that responded to a 2005 INGAA survey reported that they spent $19.6 billion for interstate pipeline infrastructure between 1993 and 2004.

criteria set forth in the *Certificate Pricing Policy Statement*,[74] and if the expansion does not benefit current customers, the services must be incrementally priced. The Commission would not approve a discount adjustment in circumstances that would shift the costs of an expansion to existing customers that did not benefit from the expansion because this would be contrary to the Commission's policy. IMGA and Northern Municipals seek rehearing of this ruling.

93. On rehearing Northern Municipals argue that the Commission failed to address the issue of how new construction can be a true competitive alternative if, in the absence of discounting, it is a higher priced alternative. Northern Municipals state that in a competitive market, the correct result is that the construction will not be undertaken because there is lower-priced capacity already available. Northern Municipals state that a competitive market is not one in which one alternative is artificially priced lower than its cost by forcing other shippers, not interested in the construction, to subsidize that construction so that it can compete with other, lower-priced service.

94. Northern Municipals state that there is no evidentiary support for the Commission's statement that as a result of expansions, there are fewer captive customers. But, they argue, even if this were true, there is still no justification for asking existing customers of a pipeline to subsidize a discount adjustment for a construction project for capacity that is not competitively priced.

95. Northern Municipals and IMGA argue that discount adjustments are contrary to the Commission's policy on expansion capacity because they distort accurate price signals. They quote the *Certificate Pricing Policy Statement* that rolled in pricing sends the wrong price signals by masking the costs of the expansion, and asserts that discounting has the same effect. Northern Municipals acknowledge the Commission's statement in the May 31 Order that it would not approve a discount adjustment in circumstances that would shift costs to customers that did not benefit from the expansion, but argues that the Commission then contradicts itself by stating that allowing an adjustment for discounts in a rate case does not amount to rolled-in pricing. Northern Municipals argue that if the rates are required to be incrementally priced under the Commission's existing policy, then an adjustment in a base rate case for discounts does constitute recovery of costs from existing shippers that do not benefit from the expansion.

96. In addressing the issue of the application of the selective discounting policy to new pipelines, there is a distinction between an entirely new pipeline and an expansion of an existing pipeline. An entirely new pipeline should have the same policies applied to it with regard to discounting as an existing pipeline. Discount adjustments only affect the

[74] 88 FERC ¶ 61,277 (1999), *order on clarification*, 90 FERC ¶ 61,128 (2000), *order on further clarification*, 92 FERC ¶ 61,094 (2000).

allocation of the costs of the pipeline that gave the discount among its own customers. Thus, the ability of a new pipeline to seek a discount adjustment in designing its own rates will not adversely affect customers of other pipelines. Shippers who are original customers on the new pipeline can negotiate risk-sharing arrangements with that pipeline before deciding to participate in the project. These original shippers are not captive customers in the same sense as captive customers on existing pipelines and, since they are not currently receiving service under the new pipeline, they clearly have other options. A newly constructed pipeline could be fully booked with firm transportation, but could obtain additional throughput through the sale of interruptible service at a discounted rate. In those circumstances, the pipeline should receive a discount adjustment, and there is no reason to create an exemption from the Commission's selective discounting policy for newly constructed pipelines.

97. The expansion of existing pipeline capacity is, however, a different situation. In the *Certificate Pricing Policy Statement,* [75] the Commission stated that in evaluating proposals for certificating new construction, the threshold question applicable to existing pipelines is whether the project can proceed without subsidies from their existing customers. This policy statement changed the Commission's previous policy of giving a presumption for rolled-in treatment for pipeline expansions. The Commission found that rolled-in treatment sends the wrong price signals by masking the true cost of capacity expansions to the shippers seeking the additional capacity. The Commission stated that the requirement that pipeline expansions should not be subsidized by existing customers is necessary for a finding of market need for the project. This generally means that expansions will be priced incrementally so that expansion shippers will have to pay the full cots of the project without subsidy from the existing customer through rolled-in pricing.

98. Thus, in most cases, expansion capacity is incrementally priced. The Commission clarifies that in these circumstances, there will be no discount adjustment for service on the expansion that affects the rates of the current shippers, since rates for that service will be designed incrementally.

99. However, the pricing policy did not eliminate the possibility that some or all of a project's costs could be included in determining existing shipper's rates. The Commission stated that rolled-in treatment would be appropriate when rolled-in rates lead to a rate decrease for the pre-expansion customers, for example because initial costly expansion results in cheap expansibility. In addition, rolled-in rates might be appropriate if the new facilities are necessary to improve service for existing customers. In

[75] 88 FERC ¶ 61,277 (1999), *order on clarification,* 90 FERC ¶ 61,128 (2000), *order on further clarification,* 92 FERC ¶ 61,094 (2000).

circumstances where the rates for expansion capacity are rolled-in, a discount adjustment can be appropriate.

F. Burden of Proof

100. In the May 31 Order, the Commission explained that under its current policy, in order to obtain a discount adjustment in a rate case, the pipeline has the ultimate burden of showing that its discounts were required to meet competition. The Commission further explained that it has distinguished between the burden of proof the pipeline must meet, depending upon whether a discount was given to a non-affiliate or an affiliate. In the case of discounts to non-affiliated shippers, the Commission stated, it is a reasonable presumption that a pipeline will always seek the highest possible rate from such shippers, since it is in the pipeline's own economic interest to do so. Therefore, the Commission stated, once the pipeline has explained generally that it gives discounts to non-affiliates to meet competition, parties opposing the discount adjustment have the burden to raise a reasonable question concerning whether competition required the discounts given in particular non-affiliate transactions. Once the party opposing the discount adjustment raises a reasonable question about the circumstances of the discount, then the burden shifts back to the pipeline to show that the questioned discounts were in fact required by competition.

101. The May 31 Order found that this allocation of the burden of proof is based on accurate assumptions and produces a just and reasonable result. The Commission stated that in view of the reasonableness and accuracy of the presumption that pipelines will seek the highest rate from non-affiliated shippers, requiring the pipeline to substantiate the necessity for all unaffiliated discounts would be unduly burdensome and would discourage a pipeline from discounting. IMGA and Northern Municipals seek rehearing of this ruling.

102. Northern Municipals assert that the burden of proof is heavily tilted in favor of the pipeline because the burden is on the opposing party, who was not privy to the original negotiations, to discover all of the details relevant to the discounts at issue, while the pipeline, who knows the most about the transaction, need do nothing at the outset to prove that the discount was necessary. Further, Northern Municipals assert, the rate case in which the discount adjustment is at issue often occurs well after the discount is made and thus, the opposing party's attempts to prove that the discounts were not necessary are invariably met with charges that they are using "twenty-twenty" hindsight to challenge the discounts. Northern Municipals state that an additional problem with the burden of proof is that in rate cases, pipelines argue that they have the right to file the last round of testimony, giving the pipeline the final opportunity to present its real justification for the discount, and there will be no opportunity for the shippers to rebut this testimony.

103. Northern Municipals argue that pipelines should be required to demonstrate, through the filing of substantial evidence in their initial cases, that the benefits to captive customers that they and the Commission assume exist, actually do exist. Thus, Northern Municipals state, pipelines would have to compare the base rates that would have existed had the discounts not been granted to the base rates that would have existed if the discounts had been granted and a discount adjustment included in the computation of base rates. They argue that this proposal would not discourage discounts, as the Commission has suggested, if the discount met the test of providing some quantifiable benefit to captive and other customers, but would only discourage discounts that do not comport with the Commission's stated rationale for its selective discount policy.

104. Northern Municipals overstate the burden placed upon parties challenging a discount adjustment. Contrary to the assertions of Northern Municipals, the burden placed upon the opponents of the discount adjustment is not an unduly heavy burden. All the challenger of a discount adjustment must do, after the pipeline has explained generally the basis for its discounts, is produce some evidence that raises a reasonable question concerning whether the discount was required to meet competition.[76] Thus, Northern Municipals' concern that, in a rate case, "the opposing party's attempts to prove that the discounts were not necessary are invariably met with charges that they are using "twenty-twenty" hindsight to challenge the discounts" is unfounded. Contrary to Northern Municipals assertion, the opponent of the discount is not required to prove that the discount was not given to meet competition, but merely has to raise a reasonable question as to the validity of the discount and the pipeline is required to show that it was made to meet competition. Further, the relevant inquiry is whether at the time the discount was given it was necessary to meet competition and this inquiry would not be dismissed as hindsight.

105. It is not an undue burden to ask the parties opposing the discount adjustment to introduce some evidence that raises a question about the need for the discount. In a rate case where the discount adjustment is challenged, all parties have an opportunity to seek discovery of the all the facts surrounding each discount. Thus, discovery will provide the parties with the information necessary to determine whether a challenge to a discount adjustment is appropriate and the ultimate burden of proof on the issue will be on the pipeline. In this regard, if a pipeline is unable in response to a discovery request to explain why competition required a particular discount, the Commission would regard that fact alone to raise a sufficient question concerning whether the discount was required to meet competition to shift the burden to the pipeline to justify the discount. Thus, pipelines must keep information relevant to each discount because if they are unable to explain and justify each discount, they will not be able to meet their burden of proof.

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[76] *See, e.g., Northern Natural Gas Co.,* 111 FERC ¶ 61,379 at P 18 (2005).

Parties may also challenge in the rate case the level of discounts given and the pipeline must be able to substantiate that the discount was not lower than what was necessary to meet competition and obtain the additional throughput. Further, Northern Municipals' concern that shippers could be denied an opportunity at a hearing to rebut the pipelines case is unfounded and Northern Municipals cite no case where this has occurred. The pipeline must present evidence showing that the discount was required by competition and the opponents of the discount have an opportunity to challenge that evidence.

106. Finally, Northern Municipals argue that the Commission should review its records and information submitted by the pipelines to determine whether pipelines are successful in recovering discounts from their remaining customers all or a majority of the time. If so, Northern Municipals argue, then the basis of the policy, *i.e.*, that pipelines will always seek the highest rate because it is in its own economic interests to do so, must be reexamined. Northern Municipals argue that if pipelines are routinely permitted to recover these discounts through rates, then they do not need to seek the highest possible rate and can agree to virtually any discount from maximum rates because their economic interests are fully protected through their ability to have their other customers subsidize their discounts. Similarly, IMGA states that the discount adjustment does not motivate the pipeline to obtain the highest rate possible for the service, but instead motivates the pipeline to grant the discount without knowing whether it is necessary to meet competition because the throughput adjustment insulates it from the risk of its own imprudence.

107. The Commission does not require the pipeline to initially present detailed evidence to substantiate that each discount was granted to meet competition because it assumes that, in the case of a discount to a non-affiliate, the pipeline will always seek the highest rate for its services because it is in its own best economic interests to do so. The Commission can make assumptions about rational business behavior and a pipeline, like any other business, can be presumed to act in its own economic best interests. Contrary to the parties' assertions here, the discount adjustment does not negate that assumption. There is no rational reason for a pipeline company to sell capacity at less that the highest rate it can charge. It would not be a good business practice for a pipeline to turn down the opportunity to put money in its pocket today through a higher rate in order to take a chance that the Commission will allow a discount adjustment in a future rate case.[77] There is no guarantee that the Commission will approve a discount adjustment and the

[77] *See, e.g., Columbia Gas Transmission Corp.,* 848 F.2d 250, 251-54 (1985) (pipeline will seek the highest possible rate).

Commission has denied pipelines this rate treatment when it has not been shown that the discounts were required by competition.[78]

108. Moreover, the discount adjustment simply allows pipelines to project future throughput based on the volumes transported during the test period for the rate case and recognizes that some of these volumes may have been transported at a discount in order to meet competition. If the projection of future volumes based on the test period discounts is accurate, the pipeline will recover its cost of service. However, if competitive circumstances change, and in the future the pipeline is required to discount below the level of the discounts during the test period, the pipeline is at risk of undercollecting its cost of service until its next rate case. On the other hand, if the pipeline can transport volumes at a rate higher than the discounted rate during the test period, it will retain that money until the next rate case. Thus, the pipeline always has an incentive to collect the highest possible rate for its service and it makes no business sense for a pipeline to discount unnecessarily. It is therefore reasonable for the Commission to make this assumption in allocating the burden of proof on this issue. As explained above, parties opposing the discount may address at the hearing, not only the issue of whether a discount was given to meet competition, but also of whether something less than the full discount is appropriate in the circumstances. The requests for rehearing are denied.

G. Protections for Captive Customers

109. In the May 31 Order, the Commission stated that opposition to the discount policy comes from a group of publicly-owned municipal gas companies that represent a small percentage of throughput on the national system, and that it is possible to adopt measures to protect these customers in individual cases where the Commission's policy works an undue hardship on them and at the same time retain the benefits of the policy for the majority of shippers. Northern Municipals and IMGA seek rehearing of this ruling.

110. These parties assert that the discount policy is opposed not only by publicly-owned municipal gas companies, but also that it is opposed at least in part by OAL, Arizona Electric Power Cooperative, Inc., the Missouri Public Service Commission, Calpine Corp., CenterPoint Energy Resources, the Northwest Industrial Gas Users, and seven members of Northern Municipals that are small-investor-owned LDCs.[79]

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[78] *See, e.g., Iroquois Gas Transmission System,* 84 FERC ¶ 61,086 at 61,476-78 (1998), *reh'g denied*, 86 FERC ¶ 61,261 (1999); *Trunkline Gas Co.,* 90 FERC ¶ 61,017 at 61,092-95 (2000).

[79] Community Utility Company, Great Plains Natural Gas Company, Northwest Natural Gas Co., Sheehan's Gas Company, Inc. Midwest Natural Gas, Inc., Superior Water Light & Power, and St. Croix Valley Natural Gas, Wisconsin.

Moreover, Northern Municipals argue, the issues raised here do not turn on whether those commenting represent a large or a small percentage of throughput. Instead, Northern Municipals assert, the relevant inquiry is whether the goals of the selective discounting policy are adequately supported by the facts and the law. Northern Municipals argue, while it may be true that the Commission can take case-specific actions to protect captive customers, this is not responsive to the issue of whether the goals of the selective discounting policy have been adequately supported by the facts and the law. Further, Northern Municipals take issue with the Commission's statement that there are already measures in place on pipelines that give captive customers special rates that provide them with protection. Northern Municipals state that a selective discounting policy that is premised on the conclusion that it will lead to increased throughput on the national grid, and benefit captive customers and others by spreading fixed costs cannot be justified by simply stating that some of the smallest customers on a pipeline receive volumetric rates, particularly where those rates are the result of settlements. [80]

111. There are only two parties that continue to oppose the discount policy, IMGA and Northern Municipals. The other parties mentioned by IMGA and Northern Municipals have not sought rehearing of the May 31 Order. In any event, the Commission's statement that only a small group of customers oppose the policy was not intended to suggest that an otherwise unsupportable policy would be appropriate because only a few shippers object to it. Instead, the statement was directed to a balancing of competing interests in this case. Because the discount policy is a significant and necessary part of the Commission's pro-competitive policies and because it provides benefits to many shippers, it is appropriate for the Commission to consider whether any negative impacts of the policy can be mitigated. If any negative impacts of the selective discounting policy are relatively few and isolated and can be corrected, then abandoning the overall benefits of the policy would not be warranted.

112. IMGA objects to the statement in the May 31 Order that one-part rates protect small customers and are subsidized by the larger customers. IMGA asserts that there is no evidence that all one-part rates are subsidized. IMGA argues that the one-part rate does not protect captive customers from unlawful discrimination caused by raising their rates to subsidize discounted rates.

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[80] Moreover, Northern Municipals assert, while 45 of its members are eligible for volumetric rates, all its members purchase service under Northern's two-part rate schedule, and therefore pay reservation charges that are impacted by discount adjustments.

113. One-part rates are offered by pipelines to small shippers to benefit those shippers by charging them lower rates than they otherwise would pay. Generally, one-part volumetric rates are based on an imputed load factor that does not reflect the actual projected volumes, but instead reflects a level designed to allocate some of the costs to larger customer services. For example, Natural Gas Pipeline Co. of America (Natural) explains that on its system the group of small municipal customers that do not have access to competitive alternatives from other pipelines or capacity release are served under Rate Schedule FTS-G (G Customers).[81] Natural states that these customers account for 1 percent of the total contract requirements on its system. Natural explains that these small customers have firm service, but pay only volumetric rates. Therefore, they have firm capacity reserved for them, but pay for service only when they actually use that capacity. Further, Natural explains, the G rate is derived from the corresponding large customer rate at an assumed 50 percent load factor, while the actual load factor of G Customers is approximately 10 percent. Natural states that under this rate structure, the G Customers pay only about 20 percent of what they would pay for the corresponding level of firm service under Rate Schedule FTS. In these circumstances, the one-part rates are subsidized because they do not recover all of the costs of the service. In any event, the Commission's reference to one-part rates was merely intended to show an example of a way that protections for small customers can be considered in individual cases.

114. Northern Municipals state that there is no evidence to support the Commission's statement that to the extent the discount policy furthers competition, it "should" encourage other pipelines to compete for the business of captive customers. Northern Municipals state that pipelines generally compete for the largest loads. Further, Northern Municipals argue that this portion of the order conflicts with the Commission's conclusion that interstate pipelines should be able to discount to compete with intrastate pipelines. Northern Municipals state that with regard to the CenterPoint discount discussed above, the competition that Northern was attempting to meet was from a new intrastate pipeline to be built. Northern Municipals state that if the pipeline had been built, it would have freed-up capacity in Northern's capacity constrained market area perhaps provided access to new or additional supply sources and increased competitive alternatives.

115. In the May 31 Order the Commission stated that as the national transportation grid becomes more competitive, there will be fewer captive customers. The Commission believes that its policies promoting competition do encourage pipelines to compete for business, including the business of captive customers, and since Order No. 636,

[81] See Comments of Natural Gas Pipeline Company of America at 14-15.

substantial new capacity has been built.[82] In any event, as we have explained above, issues concerning Northern's discount to CenterPoint can be considered in Northern's next rate case.

116. IMGA further states that while the Commission stated that it would consider the impact of discount adjustments in specific proceedings, IMGA and other captive customers have been paying higher rates than necessary and lawful because of the Commission's discount policy for the past 16 years and absent Commission action now, will continue to pay those unlawful rates. Contrary to this assertion, the current rates being paid by IMGA are lawful rates that have been found just and reasonable under section 4 of the NGA.

H. Periodic Rate Cases

117. The May 31 Order found that selective discounting does not provide a basis for requiring pipelines to file periodic rate cases. The Commission explained that, unlike the circumstances under the Commission's Purchased Gas Adjustment (PGA) clause regulations there is no adjustment mechanism that permits a pipeline to change its rates and pass additional costs through to customers between rate cases. The Commission found that in these circumstances, the procedures under sections 4 and 5 of the NGA provide sufficient protections to the pipeline's customers.

118. On rehearing, Northern Municipals argue that if a pipeline increases throughput through discounting, any resulting benefits will not accrue to captive customers until the throughput on which rates are based is adjusted in a rate case to reflect the increase. Further, Northern Municipals state that without a requirement for periodic section 4 rate filings, pipelines have the ability to manipulate the timing of their filings to maximize revenue. Northern Municipals also assert that current system rates most likely already include discount adjustments and that, to the extent that those adjustments were based on discounts that no longer accurately reflect the current level of discounting, they may or may not achieve the purposes of the selective discounting policy.

119. Further, Northern Municipals state complaint proceedings are not a solution because they are time consuming and expensive, the party filing the complaint will not have access to the information needed to file the complaint in the first place, and relief is prospective only. Northern Municipals state that in their initial comments, they asked the Commission to ask Congress to amend section 5 of the NGA to provide for refunds.

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[82] As stated above, in response to a 2005 INGAA survey, 36 pipelines reported that they had spent $19.6 billion for interstate pipeline infrastructure between 1993 and 2004, and during the 1990s interregional natural gas pipeline capacity grew by 27 percent.

Northern Municipals state that the May 31 Order does not address these shortcomings of section 5 and argues that the Commission must fully address these issues before concluding that section 5 provides sufficient protection to consumers.

120. Under section 4 of the NGA, the Commission is required to ensure that rate changes proposed by the pipeline are just and reasonable, and under section 5, if the Commission finds that the existing rate is unjust or unreasonable, it must establish the just and reasonable rate for the future. This is the statutory scheme under the NGA and it gives the Commission sufficient authority to ensure that pipeline rates are just and reasonable. A requirement that pipelines file periodic rate cases is not part of the statutory scheme, and the Commission's authority to require such filings is limited.[83] As the Commission stated in the May 31 Order, under this statutory scheme, the decision to file a rate case is always that of the pipeline and it may choose to file a rate at a time that it is advantageous for it to do so. The "shortcomings" Northern Municipals perceives in section 5 as a remedy are part of the statutory scheme. The fact that under section 5 the burden of proof is on the complainant and that relief is prospective only does not give the Commission authority to order periodic rate filings under section 4.

121. Northern Municipals argue that periodic rate filings should be required because there are similarities between the discount policy and the PGA. Northern Municipals state that the fundamental premise behind the periodic rate filing required under the PGA regulations was that, in exchange for the ability to change only one cost element, pipelines agreed to a re-examination of all their costs and rates at three-year intervals to assure that the gas cost increases were not offset by decreases in other costs. Northern Municipals state that, similarly, the premise of selective discounting is that captive customers will benefit from subsidizing discounts because there will be an increase in fixed costs spreading. But, they argue, if the discounts are not reviewed periodically, any alleged benefits may not be realized. Northern Municipals assert that this is no different in principle from saying that the pipeline under a PGA clause must examine all costs at regular intervals to assure that the gas cost increases were not offset by decreases in other costs.

122. The Commission affirms its conclusion that similarities between the PGA mechanism and the discount adjustment mechanism do not justify a periodic rate filing requirement. Under the PGA mechanism, pipelines were able to pass projected changes in their gas costs through to customers between rate cases. Thus, the rates adjudicated just and reasonable in a section 4 rate case would change prior to the next rate case to reflect increased gas costs. In exchange for this ability to increase their rates between

[83] *New York State Public Service Commission v. FERC*, 866 F.2d 487 (D.C. Cir.1989)(requiring periodic filings under NGA section 4 beyond the Commission's statutory authority).

rate cases, the pipelines agreed to a reexamination of all of their rates at three-year intervals. This is not analogous to the discount adjustment permitted in the pipeline's next rate case to reflect that not all test-period throughput volumes were transported at the maximum rate. There is no mechanism under the selective discount policy that permits shippers' rates to change between rate cases. The rates of other shippers on the system remain at the level determined to be just and reasonable in the pipeline's last section 4 rate case and are not affected until the next rate case is filed. In these circumstances a requirement that pipelines file periodic rate cases is not justified.

I. Informational Posting Requirements

123. In the May 31 Order, the Commission concluded that its current informational posting requirements provide shippers with the price transparency needed to make informed decisions and to monitor transactions for undue discrimination and preference.[84] Therefore, the Commission stated that it would not change its informational posting requirements at this time. The Commission further stated that it will refer allegations of non-compliance with the Commission's posting and reporting requirements to the Office of Market Oversight and Investigation for a potential audit and that, as part of the Commission's ongoing market monitoring program, the Commission will continue to conduct audits on its own.

124. Northern Municipals argue that the Commission erred in refusing to amend its regulations to require pipelines to post the reasons for each selective discount granted and the benefits of the discount to captive customers. They state that if customers want to oppose a discount, they must know the reason for it. Northern Municipals state that attempting to analyze a pipeline's reasons for granting the discount in a later-filed rate case raises additional issues, including whether after-the-fact justification should be permitted and whether it is more difficult for the captive customers to eliminate discount adjustments for discounts that have already been provided to favored customers.

125. As explained in the May 31 Order, under section 284.13(b) of the Commission's regulations, pipelines are required to post on their website information concerning any discounted transactions, including the name of the shipper, the maximum rate, the rate

[84] Under section 284.13(b), pipelines are required to post on their website information concerning any discounted transactions, including the name of the shipper, the maximum rate, the rate actually charged, the volumes, receipt and delivery points, the duration of the contract, and information on any affiliation between the shipper and the pipeline. Further, section 358.5(d) of the regulations requires pipelines to post on their website any offer of a discount at the conclusion of negotiations contemporaneous with the time the offer is contractually binding.

actually charged, the volumes, receipt and delivery points, the duration of the contract, and information on any affiliation between the shipper and the pipeline. Further, section 358.5(d) of the regulations requires pipelines to post on their website any offer of a discount at the conclusion of negotiations contemporaneous with the time the offer is contractually binding. This information provides shippers and the Commission with the price transparency needed to make informed decisions and to monitor transactions for undue discrimination and preference. As the court stated in *AGD I*,[85] "the reporting system will enable the Commission to monitor behavior and to act promptly when it or another party detects behavior arguably falling under the bans of §§ 4 and 5."

126. In determining whether a discount adjustment is appropriate in a rate case, the Commission determines whether the discount was required by competition at the time it was given. Thus, the competitive circumstances at the time of the discount are relevant and an "after-the-fact" justification that does not meet that standard would not support a discount adjustment. Nor would it be more difficult under this standard to "eliminate discount adjustments for discounts that have already been provided to favored customers." Therefore, the request for rehearing is denied. The Commission will not change its informational posting requirements at this time.

J. Proceeding to Investigate New Cost Allocation Methodologies

127. Northern Municipals state that in the NOI the Commission requested comments on what alternative changes in the Commission's policy could be considered to minimize any adverse effects on captive customers. Northern Municipals state that in response, it requested that the Commission institute proceedings to investigate a new cost allocation methodology that would more fairly allocate the costs of the pipeline system in proportion to the benefits a shipper derives from the system. Northern Municipals state that the Commission erred in not addressing this issue and asks the Commission address its alternative proposal on rehearing.

128. Northern Municipals ask the Commission to consider and investigate a new approach to pipeline regulation that would mandate structural separation of the pipeline networks from their parent corporations and affiliates. Under Northern Municipals' proposal, the pipeline network would be independently financed, would have its own board of directors, and would have common carrier status. Further, Northern Municipals state that the Commission should utilize a cost allocation methodology that assigns the costs of the interstate pipeline network to customers in direct proportion to the benefits that they derive from the use of the network. Northern Municipals also ask the Commission to consider implementing an independent system operator (ISO) similar to that in the electric industry.

[85] 824 F.2d at 1009.

129. In the NOI, the Commission sought comments on what alternative changes in the Commission's discount adjustment policy could be considered to minimize any adverse effect on captive customers. The issues raised by Northern Municipals are beyond the scope of this proceeding[86] and the Commission will not address them here.

The Commission orders:

The requests for rehearing are denied.

By the Commission. Commissioner Kelly dissenting in part with a separate statement attached.

(S E A L)

Magalie R. Salas,
Secretary.

[86] Some of the proposals also appear to be beyond the scope of the Commission's authority to implement.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Policy for Selective Discounting By Natural Gas Pipelines — Docket No. RM05-2-001

(Issued November 17, 2005)

KELLY, Commissioner, *dissenting in part*:

As I stated in the underlying order in this proceeding,[1] I would have supported a requirement for pipelines to post on their websites the reasons for providing a selective discount to a particular shipper. Therefore, I respectfully dissent in part on this order.

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Suedeen G. Kelly

[1] *Policy for Selective Discounting By Natural Gas Pipelines*, 111 FERC ¶ 61,309 (2005).