

NOT YET SCHEDULED FOR ORAL ARGUMENT

Nos. 09-1016 & 09-1024 (Consolidated)

**IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT**

**INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA, *et al.*,
PETITIONERS**

V.

**FEDERAL ENERGY REGULATORY COMMISSION,
RESPONDENT**

**ON PETITION FOR REVIEW OF ORDERS OF THE
FEDERAL ENERGY REGULATORY COMMISSION**

BRIEF OF INTERVENORS

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 28(a)(1) of the Federal Rules of Appellate Procedure, Fed. R. App. P. 28(a)(1), Intervenors provide this corporate disclosure statement in this proceeding.

The American Forest and Paper Association, Inc. (“AF&PA”) has no corporate parents and no publicly held company owns a 10% or more interest in AF&PA. AF&PA is a “trade association” for purposes of D.C. Cir. R. 26.1(b), and, as such, its members need not be enumerated here. AF&PA is the national trade association of the forest products industry, representing pulp, paper, packaging and wood products manufacturers, and forest landowners in the United States. Members of AF&PA own and operate facilities that consume natural gas delivered through the numerous interstate natural gas pipelines. The forest products industry accounts for approximately 5-6 percent of the total U.S. manufacturing GDP, and is on par with the automotive and chemical industries in terms of employment. Industry companies produce \$200 billion in products annually and employ nearly 1 million people earning \$54 billion in annual payroll. The industry is among the top 10 manufacturing sector employers in 48 states.

The American Gas Association (“AGA”) is incorporated under the laws of Delaware as a nonprofit, membership corporation. AGA is the national trade association of America’s natural gas distribution utilities. AGA is a “trade

association” for purposes of D.C. Cir. R. 26.1(b), and, as such, its members need not be enumerated here. AGA has no outstanding debt or equity securities in the hands of the public. AGA, founded in 1918, represents 202 gas utility companies that deliver clean natural gas throughout the United States. There are more than 70 million residential, commercial and industrial natural gas customers in the U.S., of which almost 93 percent -- more than 65 million customers -- receive their gas from AGA members. AGA is an advocate for gas utility companies and provides a broad range of programs and services for member natural gas pipelines, marketers, gatherers, international natural gas companies and industry associates. AGA member companies take service from virtually all interstate natural gas pipelines in the U.S. regulated by the Federal Energy Regulatory Commission (“FERC”). AGA has no corporate parents and no publicly held company owns a 10% or more interest in AGA.

The American Public Gas Association (“APGA”) is the national, non-profit association of publicly-owned natural gas distribution systems, with over 700 members in 36 states. Overall, there are some 950 publicly-owned systems in the United States. Publicly-owned gas systems are not-for-profit retail distribution entities that are owned by, and accountable to, the citizens they serve. They include municipal gas distribution systems, public utility districts, county districts, and other public agencies that have natural gas distribution facilities. APGA

members purchase interstate natural gas transportation services at rates and under terms and conditions that are regulated by Respondent FERC. APGA is a “trade association” within the meaning of D.C. Cir. R. 26.1(b) and thus is exempt from the requirement to list the names of its members that have issued shares or debt securities to the public. APGA has no corporate parents and no publicly held company owns a 10% or more interest in APGA.

The Independent Petroleum Association of America (“IPAA”) has no corporate parents and no publicly held company owns a 10% or more interest in IPAA. IPAA is a “trade association” for purposes of D.C. Cir. R. 26.1(b), and, as such, its members need not be enumerated here. IPAA represents the companies that drill 90 percent of the nation’s oil and natural gas wells. These companies produce 82 percent of American natural gas and 68 percent of American oil. IPAA members produce gas that is transported through almost all interstate natural gas pipelines in the United States.

The Natural Gas Supply Association (“NGSA”) has no corporate parents and no publicly held company owns a 10% or more interest in NGSA. NGSA is a “trade association” for purposes of D.C. Cir. R. 26.1(b), and, as such, its members need not be enumerated here. NGSA represents U.S.-based producers and marketers of natural gas on issues that broadly affect the natural gas industry. NGSA is the voice of suppliers who find, sell, transport and deliver approximately

30 percent of the United States' natural gas supply. Established in 1965, NGSA encourages the use of natural gas within a balanced national energy policy and promotes the benefits of competitive markets to ensure reliable and efficient transportation and delivery of natural gas and to increase the supply of natural gas to U.S. consumers. Natural gas produced by NGSA's members is transported on virtually all interstate natural gas pipelines regulated by FERC.

The Process Gas Consumers Group ("PGC") has no corporate parents and no publicly held company owns a 10% or more interest in PGC. PGC is a "trade association" for purposes of D.C. Cir. R. 26.1(b), and, as such, its members need not be enumerated here. PGC is a trade association of industrial consumers of natural gas, organized to promote the development and adoption of coordinated, rational, and consistent federal and state policies with respect to gas service to industrial gas users. PGC members own and operate hundreds of plants in virtually every state in the nation. PGC members own and operate manufacturing facilities that consume natural gas delivered through interstate natural gas pipelines systems throughout the U.S.

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**CERTIFICATE AS TO
PARTIES, RULINGS AND RELATED CASES**

Pursuant to Rule 28(a)(1) of the Federal Rules of Appellate Procedure, Fed. R. App. P. 28(a)(1), and Rule 28 of the Rules of this Court, D.C. Cir. R. 28, Intervenorers hereby state as follows:

A. PARTIES AND AMICI

The Petitioners are the Interstate Natural Gas Association of America and Spectra Energy Transmission, LLC, and Spectra Energy Partners, LP.

The Respondent is the Federal Energy Regulatory Commission.

Intervenorers include the following entities: American Forest and Paper Association, Inc. (“AF&PA”), American Gas Association (“AGA”), American Public Gas Association (“APGA”), BP Energy Company, ExxonMobil Gas & Power Marketing Company, Independent Petroleum Association of America (“IPAA”), Natural Gas Supply Association (“NGSA”), NextEra Energy Resources, LLC, Process Gas Consumers Group (“PGC”), American Iron and Steel Institute, Proliance Energy, LLC, and Shell Energy North America (US), LP.

The Intervenorers participating in this brief include the following entities: AF&PA, AGA, APGA, IPAA, NGSA, and PGC.

The parties participating in the proceedings before FERC are included in the Initial Brief of Petitioner.

B. RULINGS UNDER REVIEW

The FERC rulings under review are as follows:

- 1) *Promotion of a More Efficient Capacity Release Market*, Order No. 712, 73 Fed. Reg. 37,058 (June 30, 2008), FERC Stats. & Regs. ¶ 31,271 (2008), issued June 19, 2008, in FERC Docket No. RM08-1-000; and
- 2) *Promotion of a More Efficient Capacity Release Market*, Order No. 712-A, 73 Fed. Reg. 72,692 (Dec. 1, 2008) FERC Stats. & Regs. ¶ 31,284 (2008), issued November 21, 2008, in FERC Docket No. RM08-1-001.

C. RELATED CASES

The case on review has not previously been before this Court, and review of the FERC orders at issue here is not pending in this Court or in any other Court.

Counsel is aware of no other cases pending before FERC, this Court or any other Court that involve substantially the same issues as the case on review.

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*Authorities upon which Intervenors chiefly rely are marked with an asterisk.

GLOSSARY

AF&PA	American Forest and Paper Association, Inc.
AGA	American Gas Association
APGA	American Public Gas Association
FERC	Federal Energy Regulatory Commission
INGAA	Interstate Natural Gas Association of America
IPAA	Independent Petroleum Association of America
NGA	Natural Gas Act
NGSA	Natural Gas Supply Association
NOPR	Notice of Proposed Rulemaking
PGC	Process Gas Consumers Group
SFV	Straight Fixed-Variable rate design

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BRIEF OF INTERVENORS

The American Forest and Paper Association, Inc. (“AF&PA”), American Gas Association (“AGA”), American Public Gas Association (“APGA”), Independent Petroleum Association of America (“IPAA”), Natural Gas Supply Association (“NGSA”), and the Process Gas Consumers Group (“PGC”) (collectively “Intervenors”) are shippers receiving transportation and storage services from the interstate natural gas pipelines represented by the Petitioners, Interstate Natural Gas Association of America (“INGAA”), Spectra Energy Transmission, LLC, and Spectra Energy Partners, LP.

In the orders under review, the Federal Energy Regulatory Commission (“FERC”) adopted a more light-handed, market-based approach to the pricing of short-term re-sales of interstate pipeline transportation and storage capacity. FERC, however, did not allow market-based pricing for primary sales of pipeline capacity. Providing shippers with access to pipeline capacity at cost-based rates was a critical component of FERC’s market-based approach in order to constrain the potential exercise of market power and ensure that prices for short-term re-sales of pipeline capacity remain within a zone of reasonableness. Contrary to Petitioners’ contentions, FERC’s decisions were well-reasoned, supported, and consistent with FERC’s statutory obligation to protect natural gas consumers. Accordingly, the orders should be affirmed.

I. STATEMENT OF ISSUE

Intervenors agree with the statement of the issue as presented by the Respondent, FERC.

II. STATUTES AND REGULATIONS

Pertinent statutes are set forth in the addendum attached to this brief.

III. STATEMENT OF THE CASE

Intervenors agree with FERC’s Statement of the Case and add the following information to explain more fully the regulatory context in which the orders under

review arose. One of the primary purposes of the Natural Gas Act (“NGA”)¹ is to “protect consumers against exploitation at the hands of natural gas companies.”²

In its establishment and regulation of a capacity release program under which holders of firm transportation rights on interstate pipelines can resell those rights, FERC has acknowledged and taken various steps to fulfill its statutory obligation to protect consumers.

In Order No. 636,³ FERC instituted a uniform, national capacity release program and required then-existing capacity brokering programs to conform to the national program. FERC’s capacity release program formed an important part of its overall effort to restructure the natural gas industry to maximize the benefits to consumers of the decontrol of wellhead prices of natural gas.⁴ FERC required all capacity sales, both primary sales by the pipeline and capacity releases by shippers,

¹ Natural Gas Act, 15 U.S.C. §§ 717, *et seq.* (2006)

² *Carnegie Natural Gas Co. v. FERC*, 968 F.2d 1291, 1294 (D.C. Cir. 1992) (quoting *Fed. Power Comm’n v. Hope Natural Gas Co.*, 320 U.S. 591, 610 (1944)); *see also United Distrib. Cos. v. FERC*, 88 F.3d 1105, 1122 (D.C. Cir. 1996).

³ *See Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation; and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, Order No. 636, January 1991-June 1996 FERC Stats. & Regs. ¶ 30,939 (1992), *order on reh’g*, Order No. 636-A, January 1991-June 1996 FERC Stats. & Regs. ¶ 30,950 (1992), *order on reh’g*, Order No. 636-B, 61 FERC ¶ 61,272 (1992), *reh’g denied*, 62 FERC ¶ 61,007 (1993), *aff’d in part and remanded in part sub nom. United Distribution Cos. v. FERC*, 88 F.3d 1105 (D.C. Cir. 1996), *order on remand*, Order No. 636-C, 78 FERC ¶ 61,186 (1997), *aff’d in relevant part sub nom., United Distrib. Cos. v. FERC*, 88 F.3d 1105 (D.C. Cir. 1996).

⁴ Order No. 636 at p. 30,418.

to be administered by the pipeline through FERC-approved procedures set forth in each pipeline's tariff.⁵ FERC believed that competition among capacity sellers would help ensure that customers only pay the competitive price for available capacity.⁶ In Order No. 636, FERC also required pipelines to design rates based on a straight fixed-variable ("SFV") rate design under which customers pay all of the fixed costs of providing service in a monthly reservation charge. FERC viewed the ability of shippers to release capacity, and thus obtain revenues to offset all or a portion of the reservation charges, as an important mitigation measure to offset the consequence of adopting the SFV rate design.⁷ As a significant consumer protection measure, FERC did not allow capacity, either pipeline or released capacity, to be sold at rates in excess of a pipeline's maximum tariff rate.⁸ At the time, FERC reasoned that the extent of competition in the capacity release market may not be sufficient to ensure that the rates for released capacity will be just and reasonable.⁹

In Order No. 637, FERC revised its capacity release program to improve the efficiency of natural gas markets in light of competitive changes that had taken

⁵ Order No. 636 at p. 30,419.

⁶ Order No. 636-A at p. 30,556.

⁷ Order No. 636-A at pp. 30,597-98.

⁸ Order No. 636 at p. 30,420.

⁹ Order No. 636-A at p. 30,560.

place.¹⁰ As relevant here, FERC waived the rate ceiling for short-term capacity releases for a two-year period.¹¹ FERC believed that removal of the rate ceiling would expand shipper options, create a more efficient and more reliable marketplace, and increase market transparency while continuing to protect captive customers.¹²

In temporarily lifting the rate ceiling, FERC was mindful of its statutory obligation to protect consumers and ensure that rates remain just and reasonable.¹³ FERC relied on court precedent holding that in exercising ratemaking authority FERC is not bound to use any particular pricing formula and may adopt lighter-handed regulation as long as it ensures that the statutory goals are met.¹⁴ FERC explained that a combination of factors would ensure that capacity release rates would remain just and reasonable, “including competition among releasing shippers, regulatory changes to enhance competition, posting requirements to increase transparency, monitoring and enforcement, and the continuation of

¹⁰ *Regulation of Short-Term Natural Gas Transportation Services, and Regulation of Interstate Natural Gas Transportation Services*, Order No. 637, FERC Stats. & Regs. ¶ 30,091, *order on reh’g*, Order No. 637-A, FERC Stats. & Regs. ¶ 31,099, *order denying reh’g*, 92 FERC ¶ 61,062 (2000), *aff’d in relevant part sub nom. Interstate Natural Gas Ass’n of Amer., et al. v. FERC*, 285 F.3d 18 (D.C. Cir. 2002) (“*INGAA I*”).

¹¹ Order No. 637 at p. 31,279.

¹² Order No. 637 at p. 31,280.

¹³ *See* Order No. 637 at p. 31,284, citing *Fed. Power Comm’n v. Hope Natural Gas Co.*, 320 U.S. at 610.

¹⁴ Order No. 637 at p. 31,284, citing *Farmers Union Central Exchange v. FERC*, 734 F.2d 1486, 1509-10 (D.C. Cir. 1984) (“*Farmers Union*”).

regulation of pipeline capacity.”¹⁵ On this last point, FERC reasoned that the availability of capacity at cost-based rates from the pipelines was a critically important check on the potential exercise of market power by releasing shippers.

As FERC explained,

[b]ecause no capacity can be withheld from the market above the regulated maximum rate and buyers can always obtain capacity from the pipeline on a non-discriminatory basis, market power cannot be exercised when rates exceed the cost-of-service price ceiling, and consequently the resulting price is the competitive price needed to equate supply and demand and allocate the available capacity.¹⁶

Thus, the availability of capacity at cost-based rates from the pipelines was an important consumer protection measure enabling FERC to lift the rate ceiling on short-term capacity releases.

Order No. 637 also addressed requests by several pipelines to lift the rate ceiling on short-term pipeline capacity. FERC denied such requests offering three justifications: (1) FERC is making only incremental changes to its regulatory policies; (2) the regulation of pipeline services has been the basic protection against the potential exercise of market power; and (3) pipelines have other avenues for short-term services, including lifting the rate ceiling where the pipeline implements an auction process that protects against the exercise of market power, and market-based pricing where the pipeline can demonstrate that sufficient

¹⁵ Order No. 637-A at p. 31,559.

¹⁶ Order No. 637-A at p. 31,564.

competition in the short-term market will not permit the exercise of market power.¹⁷

Significantly, FERC's decisions were challenged from both ends. Shippers and shipper groups, including some of the Intervenor here, challenged FERC's decision to lift the rate ceiling on short-term capacity releases, while pipelines and pipeline groups challenged FERC's decision to not lift the rate ceiling on short-term pipeline capacity, a point not lost on this Court in *INGAA I*.¹⁸

In reviewing FERC's decision to lift the price ceiling on short-term capacity releases, the Court in *INGAA I* framed its consideration of FERC's decisions in the context of three issues: (1) special deference due agency experiments; (2) the NGA's mandate to regulate the rates of interstate pipelines; and (3) the *Farmers Union* criteria for review of an agency's decision to choose light-handed regulation when setting rates.¹⁹ On the last point, the Court explained that under the established criteria of *Farmers Union*, the agency must show that the goals and purposes of the statute will be met, in particular that the rates are expected to fall within a zone of reasonableness.²⁰ The Court added that non-cost factors may justify a departure from cost-based rates, and that FERC must exercise general

¹⁷ Order No. 637-A at p. 31,572.

¹⁸ See *INGAA I*, 285 F.3d at 35 (“Having been attacked for going too far with its waivers, FERC is also challenged for not going far enough.”).

¹⁹ *INGAA I*, 285 F.3d at 30.

²⁰ *Id.* at 31.

oversight to see that competition does in fact drive rates into the zone of reasonableness.²¹

The Court then applied this framework to FERC's decision to lift the rate ceiling on short-term capacity releases and concluded that FERC's decision was neither a violation of the NGA, nor arbitrary or capricious.²² The Court found that FERC had made a substantial record to support its conclusion that market rates would not materially exceed the zone of reasonableness, and that the presence of non-cost factors distinguished the case from other instances where the court set aside attempts to depart from cost-based rates. Such non-cost factors included: (1) that holders of capacity, notably captive customers – the primary intended beneficiaries of the NGA – would benefit from the decision in the form of higher payments for release of their capacity; (2) that rate ceilings on short-term capacity releases were ineffective because of the ability of capacity holders to take advantage of bundled sales; and (3) that removal of the rate ceilings would facilitate movement of capacity into the hands of those who valued it the most, reducing transaction costs and increasing transparency.²³

The Court then turned to FERC's decision not to lift the rate ceilings on short-term pipeline capacity and determined that FERC's distinction between

²¹ *Id.*

²² *Id.* at 35.

²³ *Id.* at 33-34.

capacity releases and pipeline sales of capacity was not unreasonable. As the Court explained, while the uncontracted-for capacity of a pipeline was presumptively available for the short-term market, “no such presumption makes sense for the non-pipeline capacity holders: they presumably contracted for the capacity in anticipation of actually using it.”²⁴ The Court also accepted FERC’s justification that pipelines have other options for market-based pricing, including showing that there is sufficient competition in the short-term market to preclude the exercise of market power or obtaining authorization to sell capacity by auction.²⁵

Thus, this Court in *INGAA I* upheld FERC’s decision not to lift the rate ceilings on short-term sales of pipeline capacity not simply out of heightened deference to an agency’s experiment, but because, in the context of FERC’s exercise of ratemaking authority over both capacity releases and sales of pipeline capacity, FERC’s decisions were adequately explained and supported, applying the well-established criteria set forth in *Farmers Union*.

As the Court noted, FERC has granted pipelines significant pricing flexibility with regard to sales of both short-term and long-term capacity. In each case, however, FERC has taken steps to include consumer protections that help

²⁴ *Id.* at 35.

²⁵ *Id.*

constrain the potential exercise of market power and ensure that rates remain just and reasonable.

FERC has long permitted pipelines to engage in selective discounting, which this Court has approved.²⁶ Under FERC's discounted rate program, 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.²⁷ As an important consumer protection, the pipeline bears the burden of showing that its discounts were required to meet competition in order to obtain a discount adjustment.²⁸ Moreover, FERC considers the impact of any discount adjustment on captive customers in specific proceedings involving discount adjustments.²⁹

Also, since 1996, FERC has permitted pipelines to negotiate rates with shippers that vary from their cost-based rates not only in rate levels but also in rate design.³⁰ Under negotiated rates, pipelines are able to offer a wide range of

²⁶ See, e.g., *United Distrib. Cos. v. FERC*, 88 F.3d at 1142; see also *Associated Gas Distributors v. FERC*, 824 F.2d 981 (D.C. Cir. 1987).

²⁷ *Policy for Selective Discounting by Natural Gas Pipelines*, 111 FERC ¶ 61,309 at P 4, *order denying reh'g*, 113 FERC ¶ 61,173 (2005) ("Policy for Selective Discounting").

²⁸ *Id.*, 111 FERC ¶ 61,309 at P 59.

²⁹ *Id.* at P 57.

³⁰ *Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines, Regulation of Negotiated Transportation Services of Natural Gas*

services including individually tailored seasonal services and rates, and short-term services.³¹ In addition, FERC has allowed negotiated rates to exceed the pipeline's maximum tariff rate. However, in doing so FERC has consistently required as a fundamental consumer protection that shippers be able to contract with the pipeline at a cost-based "recourse" rate. "[T]he availability of a recourse service would prevent pipelines from exercising market power by assuring that the customer can fall back to cost-based, traditional service if the pipeline unilaterally demands excessive prices or withholds service."³²

Significantly, FERC has allowed pipelines to use basis differentials as a pricing mechanism.³³ Under that method, the price for transportation service between two points is based on the difference between gas commodity price indices at each point, and reflects the implicit value of the transportation between such points. As consumer protections for this particular type of pricing, FERC noted that pipelines must sell capacity to maximum rate bidders; that pipelines must file all negotiated rate contracts with FERC; that FERC monitors gas price

Pipelines, 74 FERC ¶ 61,076, at pp. 61,238-42, *order on clarification*, 74 FERC ¶ 61,194, *order on reh'g*, 75 FERC ¶ 61,024 (1996) ("*Alternative Rate Policy Statement*").

³¹ *Id.*, 74 FERC at p. 61,240.

³² *Id.*

³³ *Natural Gas Pipeline Negotiated Rate Policies and Practices*, 114 FERC ¶ 61,042, *order dismissing reh'g*, 114 FERC ¶ 61,304 (2006).

indices and basis differentials; and that FERC has expanded enforcement authority to prevent market manipulation.³⁴

FERC also allows pipelines to charge market-based rates where the pipeline can show that it lacks significant market power in the relevant markets.³⁵ In order to protect customers and fulfill its statutory obligation to ensure that prices remain just and reasonable, FERC requires a market-based rate proponent to submit a rigorous market power analysis defining the relevant markets, measuring the market concentration and the firm's market share, and evaluating other relevant factors.³⁶

Against this background, the rulemaking proceedings that led to the orders under review began with the Petition for Rulemaking filed in July 2006, by Pacific Gas & Electric Company and Southwest Gas Corporation requesting that rate ceilings be lifted permanently for capacity release transactions. JA ____-____.³⁷ The petition noted that FERC's negotiated rate policy permits pipelines to sell capacity using basis differential pricing and rates for pipeline capacity can exceed the pipeline's maximum tariff rate, but that shippers releasing capacity are limited to

³⁴ *Id.*, 114 FERC ¶ 61,042 at P 10 (citing Energy Policy Act § 315, Pub. L. No. 109-58, 119 Stat. 594 (2005), codified at Natural Gas Act § 4A, 15 U.S.C. § 717c-1 (2006)).

³⁵ *See Alternative Rate Policy Statement*, at p. 61,227.

³⁶ *Id.*, 74 FERC at p. 61,231.

³⁷ The two-year experiment in lifting the rate ceiling approved in Order No. 637 had expired in September 2002 and was not extended.

pricing their capacity re-sales to the pipeline's maximum tariff rate. JA ____-____.

As a result, not only were shippers unable to compete with the pipelines in selling capacity using basis differential pricing, they were also limited in their ability to mitigate the cost of holding capacity which they purchased under basis differential pricing. To address this anomaly, the petition asked FERC to give shippers pricing flexibility and eliminate the rate ceilings on capacity releases. JA ____.

In response to this petition, FERC requested comments from the industry on whether changes in its capacity release program would improve the efficiency of the natural gas market, including whether FERC should permanently lift the rate ceilings on short-term capacity release transactions.³⁸ Comments filed in response to FERC's request ran the gamut. Some supported lifting the rate ceilings on short-term capacity release transactions,³⁹ while others generally opposed it arguing that FERC could not do so unless it had new data to support that the rates would remain just and reasonable.⁴⁰ Still others argued that in order to lift the rate ceilings on capacity releases FERC must demonstrate the absence of market power in the capacity markets.⁴¹ Pipelines argued that FERC should remove the rate

³⁸ *Pacific Gas & Electric Co., et al.*, 118 FERC ¶ 61,005 (2007). JA ____-____.

³⁹ *See, e.g.*, Comments of AGA at pp. 5-6. JA ____-____.

⁴⁰ *See, e.g.*, Comments of the Process Gas Consumers Group and the American Forest & Paper Association ("PGC/AF&PA") at p. 5 (JA ____), Comments of the Natural Gas Supply Association ("NGSA") at p. 3 (JA ____).

⁴¹ *See* Comments of the American Public Gas Association ("APGA") at p. 12. JA ____.

ceilings on pipelines' capacity as well⁴² – an argument that was adamantly and uniformly opposed by shippers.⁴³

Based on the comments, FERC proposed to lift the rate ceiling on short-term capacity release transactions of one year or less but to retain the rate ceiling on pipeline sales of capacity.⁴⁴ FERC reasoned that removal of the rate ceilings would allow shippers to offer competitive alternatives to pipelines' negotiated rate offerings.⁴⁵ Applying the analytical framework from *Farmers Union* as set forth in *INGAA I*, FERC concluded that its proposed departure from cost-based ratemaking was justified.⁴⁶ FERC explicitly relied on the ability of shippers to obtain capacity from the pipeline at cost-based, recourse rates to protect consumers from the potential exercise of market power.⁴⁷ In retaining the rate ceilings for sales of pipeline capacity, FERC added that “the price ceilings on pipeline capacity serve as an effective recourse rate for both pipeline and negotiated rate transactions and

⁴² See, e.g., Comments of INGAA at p. 3 (JA ____), Spectra Energy Transmission at p. 3 (JA ____).

⁴³ See, e.g., Comments of AGA at pp. 6 (JA ____), Comments of PGC/AP&PA at pp. 11-12 (JA ____-____), Comments of NGSA at pp. 6-7 (JA ____-____), Reply Comments of APGA (JA ____-____), Reply Comments of Nicor Gas Company (JA ____-____).

⁴⁴ *Promotion of a More Efficient Capacity Release Market*, Notice of Proposed Rulemaking, 72 Fed. Reg. 65,919 (Nov. 26, 2007), FERC Stats. & Regs., Proposed Regs. ¶ 32,625 at PP 23, 48 (2007) (“*NOPR*”). JA ____, ____.

⁴⁵ *Id.* at P 25. JA ____.

⁴⁶ *Id.* at P 29. JA ____.

⁴⁷ *Id.* See also, *id.* at PP 40-41. JA ____-____.

capacity release transactions to prevent pipelines and releasing shippers from withholding capacity.”⁴⁸

In comments on the NOPR, shippers supported lifting the rate ceilings on short-term capacity releases, in large part because rate ceilings were maintained for pipeline sales of capacity.⁴⁹ NGSAs stated that it did not oppose lifting of the rate ceilings on capacity releases if FERC took steps to effectively protect customers against the exercise of market power, including prohibiting pipeline capacity from being sold at above-tariff rates.⁵⁰ Similarly, PGC believed that FERC’s bedrock responsibility under the NGA is to protect consumers from the exercise of pipeline market power, and that cost-based rates have been critical in preventing pipelines from using market power to extract excessive charges from shippers and undermining the public’s interest in vital gas supply markets.⁵¹

In the Final Rule, FERC adopted its capacity pricing proposals lifting the rate ceilings for capacity release transactions of one year or less but retaining the price ceilings for primary sales of pipeline capacity.⁵² Again, applying the *Farmers Union/INGAA I* analytical framework, FERC reviewed: “(1) the extent to

⁴⁸ *Id.* at P 49. JA ____.

⁴⁹ *See, e.g.*, Comments of AGA at pp. 30-32 (JA ____-____); Comments of APGA at p. 5 (JA ____).

⁵⁰ *See* Comments of NGSAs at p. 3. JA ____.

⁵¹ *See* Comments of PGC at p. 5. JA ____.

⁵² *Promotion of a More Efficient Capacity Release Market*, Order No. 712, 73 Fed. Reg. 37,058 (June 30, 2008), FERC Stats. & Regs. ¶ 31,271 (2008). JA ____-____.

which market conditions and other factors may be expected to keep short-term capacity release prices within a reasonable zone despite the removal of the price ceiling, (2) the non-cost factors supporting a removal of the price ceiling, and (3) our oversight of the short-term capacity release market after removal of the price ceiling.”⁵³ While FERC determined that the short-term capacity release market was “generally competitive,”⁵⁴ its finding was not based on a traditional market power analysis that would satisfy the requirements for a finding of lack of market power. Rather, FERC reviewed its recent policy initiatives that have enhanced competition as well as natural gas market data to conclude that “competition, together with our continuing requirement that pipelines must sell short-term firm and interruptible services to any firm shipper offering the maximum rate, and the Commission’s ongoing monitoring efforts will keep short-term capacity release rates within the ‘zone of reasonableness’ required by [*INGAA I*] and *Farmers Union*.”⁵⁵ Here again, FERC relied on shippers’ access to pipeline capacity at cost-based rates as an important consumer protection against the potential exercise of market power in the short-term capacity release markets.⁵⁶

⁵³ Order No. 712 at P 38. JA ____.

⁵⁴ *Id.* at P 39. JA ____.

⁵⁵ *Id.*

⁵⁶ *See id.* at P 48.

In addition, as described in Respondent’s brief, FERC addressed each of the arguments made in favor of lifting the rate ceilings for pipeline sales of capacity.⁵⁷ In the main, FERC reiterated that pipelines already have significant pricing flexibility to exceed the rate ceilings through market-based negotiated rates, and that lifting the rate ceilings for short-term capacity releases was designed to permit releasing shippers some of the same flexible pricing authority FERC had already granted to pipelines.⁵⁸ FERC was clear that lifting the rate ceilings for pipeline capacity sales “would effectively negate the recourse rate protection we included in the negotiated rate program.”⁵⁹

Significantly, no entity sought rehearing of FERC’s decision to lift the rate ceilings on short-term capacity release transactions; only the pipelines challenged FERC’s decision not to remove the rate ceilings on short-term pipeline services. In denying rehearing, FERC maintained that retention of the rate ceilings on short-term pipeline services was necessary to protect against the exercise of market power.⁶⁰ Again, as described in Respondent’s brief, FERC addressed all of the arguments raised on rehearing.⁶¹ All told, FERC devoted more than 45 pages in Order Nos. 712 and 712-A explaining its decision to retain the rate ceilings on

⁵⁷ See *id.* at PP 81. JA ____-____.

⁵⁸ See *id.* at PP 82-83. JA ____-____.

⁵⁹ *Id.* at P 82. JA ____.

⁶⁰ *Promotion of a More Efficient Capacity Release Market*, Order No. 712-A, 73 Fed. Reg. 72,692 (Dec. 1, 2008), FERC Stats. & Regs. ¶ 31,284 (2008).

⁶¹ See *id.* at PP 13-56. JA ____-____.

short-term pipeline services and addressing all of the pipelines' arguments challenging that decision.

The petitions followed. Of note, unlike last time before the *INGAA I* court, shippers are not challenging FERC's decisions as going too far. Only the pipelines continue to argue that FERC has not gone far enough.

IV. SUMMARY OF ARGUMENT

FERC's decisions to lift the rate ceilings on short-term capacity releases but to retain them on pipeline sales of capacity are well-reasoned and well-supported. As such, they should be affirmed.

FERC appropriately applied a familiar framework under *Farmers Union* and *INGAA I* in exercising its ratemaking authority to adopt a lighter-handed approach that departs from cost-of-service pricing. Retaining the rate ceilings on pipeline sales of capacity allows FERC to fulfill its statutory mandate to protect natural gas consumers and provides assurance that FERC's lighter-handed approach to capacity pricing will accomplish that goal of the NGA to ensure that rates remain just and reasonable. Moreover, lifting the rate ceilings on pipeline sales of capacity would seriously undermine FERC's negotiated rate program. If FERC were to lift the rate ceilings for short-term sales of pipeline services, shippers would not have access to a cost-based recourse rate.

Contrary to the erroneous premise underlying Petitioners' Brief, the short-term markets for capacity have not been shown to lack the potential for the exercise of market power sufficient to allow them to be deregulated, and FERC did not find as much. This erroneous premise leads Petitioners to the equally erroneous contention that pipelines and capacity holders are equal competitors in the short-term capacity markets. They are not similarly situated as capacity sellers. Pipelines have vastly superior information regarding the availability of transportation and storage capacity on their own systems to which shippers do not have access. Moreover, pipelines have the ability to expand their systems – a distinction that was not lost on FERC.

Petitioners' claim that there is no evidence to suggest that pipelines have market power in the short-term market is flatly contradicted by FERC precedent. FERC recently rejected a pipeline's request for market-based rate authority for its short-term interruptible services because the pipeline could not demonstrate a lack of market power. Petitioners' further claims that FERC has harmed pipelines' ability to recover their costs are equally contradicted by FERC precedent. Indeed, FERC has recently had to address quite the opposite concern – that pipelines are *over-recovering* their costs.

Finally, this Court should not be distracted by Petitioners' constrained view of *INGAA I*. That case is not limited by the fact that the Court was reviewing an

agency experiment. Rather, the Court in *INGAA I* set out the analytical framework for evaluating an agency's decision to depart from cost-of-service rates in exercising lighter-handed ratemaking authority. As such it is directly applicable, and FERC's orders under review here should be upheld on the same basis.

V. ARGUMENT

Intervenors do not address all of the arguments Petitioners make in their Initial Brief, but expand on certain points in Respondent's Brief to assist the Court in its analysis of this case.

A. FERC Applied An Appropriate Analytical Framework.

In the orders under review, FERC employed a now familiar analytical framework for exercising ratemaking authority to adopt a lighter-handed regulatory approach that departs from cost-of-service pricing. As set forth in *Farmers Union* and *INGAA I*, FERC may adopt light-handed regulation if it shows that the goals and purposes of the NGA will be accomplished, in particular, that resulting rates can be expected to fall within a zone of reasonableness where they are neither less than compensatory nor excessive.⁶² In addition, while the expected rates should approximate cost, non-cost factors may justify a departure from a rigid, cost-based approach. Moreover, FERC must retain general oversight to ensure that its

⁶² See *INGAA I*, 285 F.3d at 31.

approach to regulation in fact results in rates that are within the zone of reasonableness.⁶³

Applying this framework, FERC reasonably decided to lift the rate ceilings on short-term capacity releases while retaining them on pipeline sales of capacity. Throughout the course of this proceeding, FERC has consistently stated that the availability of capacity from the pipeline at cost-based, recourse rates was a critically important consumer protection against the potential exercise of market power with regard to both capacity releases and pipeline sales of capacity.⁶⁴ Retaining the rate ceilings on pipeline sales of capacity thus allows FERC to fulfill its statutory mandate to protect consumers and provides assurance that FERC's light-handed approach to the pricing of capacity will accomplish the goal of the NGA to ensure that rates remain just and reasonable.⁶⁵

Indeed, lifting the rate ceilings on pipeline sales of capacity would seriously undermine FERC's negotiated rate program. As noted above, FERC allows pipelines to negotiate rates with their shippers that can vary from their cost-based rates both in rate level and in rate design. Rates can be negotiated for short-term services, long-term services, and for services that support the construction of new pipeline facilities. In all cases, however, shippers have access to a cost-based,

⁶³ *See id.*

⁶⁴ *See* NOPR at PP 40-41, 49 (JA ____-____, ____); Order No. 712 at PP 48, 82 (JA ____, ____); Order No. 712-A at P 16 (JA ____).

⁶⁵ *See* *INGAA I*, 285 F.3d at 31.

recourse rate in order to prevent the exercise of market power if the pipeline unilaterally demands excessive prices or withholds service.⁶⁶ If FERC were to lift the rate ceilings for short-term sales of pipeline services, shippers would not have access to a cost-based recourse rate. In the absence of a showing of lack of market power, FERC could not be assured that the goals of the NGA (protecting customers and ensuring that rates remain just and reasonable) would be accomplished. As FERC determined, lifting the rate ceilings on pipeline sales of capacity would effectively negate the recourse rate protection in the negotiated rate program.⁶⁷

B. Petitioners' Contentions Are Without Merit.

Contrary to the fundamental premise underlying Petitioners' Brief, the short-term markets for capacity have not been shown to lack market power sufficient to allow them to be deregulated. FERC was clear in Order No. 712-A that it did not find the entire market for short-term capacity re-sales to be competitive in the sense that a traditional market power analysis examining market concentrations and market shares would support deregulated rates.⁶⁸ Rather, FERC found that the extent of competition in the short-term capacity release market, *coupled with the protection of access to a cost-based recourse rate for pipeline services* was

⁶⁶ *Alternative Rate Policy Statement*, 74 FERC at p. 61,240.

⁶⁷ See Order No. 712 at P 82. JA ____.

⁶⁸ See Order No. 712-A at PP 23, 26. JA ____, ____.

sufficient to justify a lighter-handed regulatory approach under the familiar framework of *Farmers Union* and *INGAA I*.⁶⁹ Petitioners mischaracterize these findings in an attempt to erroneously suggest that, because capacity release markets are “competitive,” the markets for short-term pipeline services must be competitive as well. In other words, Petitioners seek to obtain the benefit of a determination that pipeline short-term services are “competitive” in the sense of supported by traditional market power analysis that would justify market-based rates without actually having to conduct a traditional market power analysis.

This erroneous premise then leads Petitioners to the equally erroneous contention that pipelines and capacity holders are equal competitors in the short-term capacity markets. *See* Petitioners’ Brief at p. 21. To be sure, capacity releases can be an alternative to pipeline sales of capacity. That fact alone, however, does not justify a finding that pipelines and their shippers are similarly situated as capacity sellers. As this Court recognized in *INGAA I*, pipelines and their shippers are not similarly situated.⁷⁰ The Court determined that, “whereas the uncontracted for capacity of a pipeline is presumptively available for the short-term market, no such presumption makes sense for the non-pipeline capacity

⁶⁹ *See id.*

⁷⁰ *INGAA I*, 285 F.3d at 35.

holders: they presumably contracted for the capacity in anticipation of actually using it.”⁷¹

Indeed, this proceeding began through an effort to remove a competitive disadvantage capacity holders were experiencing in not having the kind of pricing flexibility the pipelines enjoyed. As FERC observed, it “has previously provided pipelines with the flexibility to enter into negotiated rate transactions which are permitted to exceed the maximum rate ceiling, and this rule will permit releasing shippers similar flexibility in pricing release transactions.”⁷² Despite the fact that FERC has provided shippers additional pricing flexibility in the orders under review, it cannot be said that shippers are on equal footing with the pipelines. Pipelines have the advantage. Pipelines have vastly superior information regarding system operations to which shippers do not have access. As a consequence, pipelines know whether and how much capacity is available and in what areas given the bottlenecks and constraints on their systems. Moreover, pipelines have the ability to expand their systems to add capacity, make changes in operations, or eliminate bottlenecks and constraints. These distinctions were not lost on FERC.⁷³

As a result of these differences, pipelines and their shippers are simply not equal

⁷¹ *Id.*

⁷² Order No. 712 at P 30. JA ____.

⁷³ *See* Order No. 712-A at P 31 (“Unlike shippers that cannot control the total amount of capacity, pipelines, because they control their own systems, can affect the total quantum of capacity by determining whether to construct additional capacity.”). JA ____.

competitors in the capacity markets. FERC rationally took these differences into account in exercising its ratemaking authority.

Petitioners make the astonishing claim that there is no evidence to suggest that pipelines have market power in the short-term market. *See* Petitioners' Brief at pp. 31-33. It is the Petitioners' burden to demonstrate a lack of market power in order to obtain market-based pricing, not FERC's to demonstrate the existence of market power. Indeed, as FERC noted, "INGAA provide[d] no data supporting its contention that the markets are competitive."⁷⁴

Petitioners' claim follows from its erroneous characterization of FERC's finding that short-term capacity markets are "generally competitive." As noted, FERC did not find that the entire short-term market for capacity re-sales was competitive in any way that would pass muster under a traditional market power analysis.⁷⁵ Petitioners misinterpret FERC's finding and then proceed to fault FERC for failing to provide evidentiary support when FERC attempts to correct Petitioners' misinterpretation.

Fundamentally, FERC was under no obligation to provide evidence to counter Petitioners' mischaracterization of FERC's findings. More importantly, notwithstanding the record in the proceedings under review, Petitioners' suggestion that there is no evidence of a lack of competition in the short-term

⁷⁴ Order No. 712-A at P 53. JA ____.

⁷⁵ *See* Order No. 712-A at PP 23, 26. JA ____, ____.

market is flatly contradicted by FERC precedent. Recently, FERC issued an order rejecting a proposal by a pipeline to charge market-based rates for its interruptible services on the grounds that the pipeline failed to show that it lacked market power in the relevant markets.⁷⁶ In that case, the pipeline had asserted, among other things, that released capacity by shippers on its system competed with its interruptible services; however, FERC concluded that the pipeline's assumptions regarding the availability of released capacity as an alternative to pipeline interruptible services were unsupported.⁷⁷ Contrary to Petitioners' implicit suggestion, a lack of competition in short-term markets has prevented at least one pipeline from justifying market-based rates for its interruptible services.

Petitioners' claims that FERC has harmed pipelines are equally contradicted by FERC precedent. Petitioners argue that their harm is not mitigated by the ability to file a rate case because in a competitive market pipelines will not be able to charge full rates and will not be able to recover their costs. *See* Petitioners' Brief at pp 35-37. This assertion is simply not true. Under FERC's discounted rate program, pipelines can obtain a discount adjustment in their rates where they can show that the discounts were given to meet competition.⁷⁸ As a result, FERC ensures that pipelines are able to design their rates so as to be able to recover their

⁷⁶ *See Gas Transmission Northwest Corp.*, 119 FERC ¶ 61,288 (2007).

⁷⁷ *Id.* at P 35.

⁷⁸ *Policy for Selective Discounting*, 111 FERC ¶ 61,309 at P 4.

costs even when they must discount to meet competition. Thus, pipelines *are* able to recover their costs.

Petitioners' concern, however, appears to be more with the ability to recover costs in the market-place than with the opportunity to recover costs through rate design. In that regard, Petitioners ignore the ways in which pipelines are able to increase revenues in between rate cases, such as making additional sales, *i.e.*, increasing sales above the levels upon which the rates were based. Indeed, even when a pipeline has to discount its rates to make additional sales, whenever the sales levels rise above the level upon which the rates were designed (adjusting the levels to reflect the discounts given), the pipeline can be said to be *over-recovering* its costs (all other factors being equal). Pipelines can also expand their systems to increase available capacity. In some instances, the cost of the expansion is low enough that the pipeline's rates would not need to be increased in order for the pipeline to recover the expansion costs.⁷⁹ In those cases, charging the existing rates would allow the pipeline to more than recover its costs of expansion.

This Court should not succumb to Petitioners' implicit suggestion that pipelines are unable to recover their costs as a result of FERC's decisions in the orders under review. On the contrary, FERC has recently had to address quite the

⁷⁹ *See, generally, Iroquois Gas Transmission System, LP v. FERC*, 172 F.3d 84, 84-85 (D.C. Cir. 1999) (addressing cheap expansibility, *i.e.*, the situation where the capacity of the pipeline can be expanded at less than system cost – “adding compressor stations would (or at least could) bring down average cost.”).

opposite concern – that pipelines are *over-recovering* their costs. In the proceedings that led to FERC Order No. 710,⁸⁰ FERC noted two recent complaints filed against interstate pipelines alleging substantial over-recovery of costs.⁸¹ In one case, the complaint alleged that the pipeline was earning a return on equity as high as 32 percent.⁸² In Order No. 710, FERC revised its financial reporting requirements for interstate pipelines in an effort to provide customers with the financial data they need to monitor and challenge whether pipelines’ cost-based rates remain just and reasonable.⁸³ In any event, a pipeline has the ability to file a rate case to recover prudently incurred costs. Consequently, the Court need not be concerned by Petitioners’ claims that pipelines are unable to recover their costs.

Finally, Petitioners erroneously argue that *INGAA I* has no applicability to this case because the Court in that case only approved an experiment. *See* Petitioners’ Brief at pp 50-53. The Court should not be distracted by this constrained view of *INGAA I*. To be sure, the Court in *INGAA I* did note that it

⁸⁰ *Revisions to Forms, Statements, and Reporting Requirements for Natural Gas Pipelines*, Order No. 710, 73 Fed. Reg. 19,389 (Apr. 10, 2008), FERC Stats. & Regs. ¶ 31,267 (2008), *order on reh’g*, Order No. 710-A, 73 Fed. Reg. 36,414 (June 27, 2008), 123 FERC ¶ 61,278 (2008), *appeal pending sub nom. Amer. Gas Assoc. v. FERC*, D. C. Cir. No. 08-1266 (filed Aug. 15, 2008).

⁸¹ *See Revisions to Forms, Statements, and Reporting Requirements for Natural Gas Pipelines*, Notice of Proposed Rulemaking, 72 Fed. Reg. 54,860 (Sep. 27, 2007), FERC Stats. & Regs., Proposed Regs. ¶ 32,623 at PP 7-9 (2007).

⁸² *Id.* at P 9, citing *Panhandle Complainants v. Southwest Gas Storage Co.*, 117 FERC ¶ 61,318 (2006).

⁸³ *See* Order No. 710 at P 1.

gave special deference to agency experiments,⁸⁴ and in the orders under review FERC adopted a lighter-handed ratemaking approach to the pricing of capacity re-sales on a permanent basis, not as part of an experiment. This distinction, however, does not render *INGAA I* irrelevant as Petitioners suggest.

On the contrary, as described above, *INGAA I* sets out the analytical framework for evaluating an agency's decision to depart from cost-of-service rates in exercising lighter-handed ratemaking authority. In both Order No. 637 at issue in *INGAA I* and in the orders under review at issue here, FERC applied this analytical framework to explain its actions. In *INGAA I*, the Court upheld FERC's pricing decisions as adequately explained in the context of that framework. In that important sense, *INGAA I* is directly applicable. As set forth in the orders under review here and as fully described in Respondent's Brief, FERC has again adequately explained its pricing decisions in the context of the framework set out in *INGAA I*. As a result, its decisions should be upheld. For these reasons and for those expressed in Respondent's Brief, FERC's orders under review are well-reasoned and supported and should be upheld.

⁸⁴ *INGAA I*, 285 F.3d at 30.

VI. CONCLUSION

Based on the foregoing, the petitions for review should be denied and the orders upheld.

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November 16, 2009

CERTIFICATE OF COMPLIANCE

Pursuant to Rules 28(a)(11) and 32(a)(7) of the Federal Rules of Appellate Procedure, Fed. R. App. P. 28(a)(11), 32(a)(7) and Rule 32 of the Rules of this Court, I hereby states that this brief contains 6,868 words.

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ADDENDUM

Natural Gas Act § 4A, 15 U.S.C. § 717c-1 (2006) provides as follows:

Sec. 717c-1. Prohibition on market manipulation

It shall be unlawful for any entity, directly or indirectly, to use or employ, in connection with the purchase or sale of natural gas or the purchase or sale of transportation services subject to the jurisdiction of the Commission, any manipulative or deceptive device or contrivance (as those terms are used in section 78j(b) of this title) in contravention of such rules and regulations as the Commission may prescribe as necessary in the public interest or for the protection of natural gas ratepayers. Nothing in this section shall be construed to create a private right of action.

CERTIFICATE OF SERVICE

Pursuant to Fed. R. App. P. 25(d), and this Court's Administrative Order Regarding Electronic Filing, I hereby certify that I have this date served the foregoing upon the counsel listed in the Service Preference Reports via e-mail through the Court's CM/ECF system and via first class mail, postage prepaid, as set forth below:

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Association, Independent Petroleum
Association of America, Natural Gas Supply
Association, Process Gas Consumers Group