UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Petition for Rulemaking to Update	**)**	
Commission Regulations Regarding	**)**	Docket No. RM22-____-000
Allocation of Interstate Pipeline Capacity	**)**	

PETITION FOR RULEMAKING TO UPDATE COMMISSION REGULATIONS REGARDING THE ALLOCATION OF INTERSTATE NATURAL GAS PIPELINE CAPACITY OF THE AMERICAN GAS ASSOCIATION, AMERICAN PUBLIC GAS ASSOCIATION, PROCESS GAS CONSUMERS GROUP, AND NATURAL GAS SUPPLY ASSOCIATION

Pursuant to Rule 207(a)(4) of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission ("FERC" or "Commission"), 18 C.F.R. § 385.207(a)(4) (2021), the American Gas Association ("AGA"), American Public Gas Association ("APGA"), Process Gas Consumers Group ("PGC"), and Natural Gas Supply Association ("NGSA") (collectively, the "Petitioners") submit this Petition for Rulemaking ("Petition"), and respectfully request that the Commission conduct a rulemaking to adopt a rule precluding natural gas pipelines from the practice of aggregating bids on non-contiguous segments of capacity in determining the highest value bid for the purpose of allocating capacity.

I. INTRODUCTION

The interstate pipeline practice of packaging high market value capacity with non-contiguous and operationally unrelated parcels of unwanted capacity with little or no market value is becoming increasingly commonplace in the market. Petitioners' request is based upon new evidence, as described below, which demonstrates that, despite the Commission's prior rulings which anticipated that this practice would benefit shippers, pipelines appear to utilize this practice to exercise market power. This practice forces shippers to bid an artificially inflated price for valuable capacity tied to unwanted capacity, thereby enabling a pipeline to collect revenue from shippers above the Commission approved maximum tariff rates for the high market value capacity. The Commission previously held that customers would be protected from harm if the pipeline's tariff did not technically require bids on non-contiguous segments. However, the evidence shows that customers are effectively required to bid on unwanted capacity with little or no market value in order to obtain the segments of high market value capacity on the pipeline, or lose access to the needed capacity. This practice unduly discriminates against captive industrial customers, municipal gas systems, and local distribution companies. This practice also harms all shippers, including marketers, because it unnecessarily raises transportation costs to their customers, who include industrials, utilities, generators and other end users. Finally, while the Commission previously expected that shippers would receive benefits in future rate cases, it appears that shippers have not received any such benefits.

To date, the Commission has only considered this issue within the narrow context of tariff filings by individual pipeline companies and not on a generic basis. Petitioners submit there is a sufficient basis for the Commission to open a rulemaking to consider whether this practice has become unjust, unreasonable and unduly discriminatory in the manner in which it has been implemented. Petitioners request that the Commission revise its regulations as necessary to prohibit this practice, protect consumers from unjust and unreasonable rates and provide all shippers with the fair and unencumbered opportunity to acquire pipeline capacity as envisioned in the Commission's open access regulatory regime.

II. COMMUNICATIONS

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II. IDENTITY AND INTERESTS

AGA, founded in 1918, represents more than 200 local energy companies that deliver clean natural gas throughout the United States. There are more than 77 million residential, commercial, and industrial natural gas customers in the U.S., of which 95 percent — more than 73 million customers — receive their gas from AGA members. AGA is an advocate for natural gas utility companies and their customers and provides a broad range of programs and services for member natural gas pipelines, marketers, gatherers, international natural gas companies, and industry associates. Today, natural gas meets more than one-third of the United States' energy needs.

AGA's local distribution company ("LDC") members own and operate local natural gas distribution pipeline systems that typically receive natural gas supplies that have been transported on the interstate pipeline system. LDCs deliver natural gas under locally-regulated rates, terms, and conditions, directly to residential, commercial, and industrial customers, including electric generators. AGA members take service from virtually every interstate natural gas pipeline regulated by the Commission under the Natural Gas Act ("NGA"). As customers of jurisdictional pipelines and providers of natural gas distribution service to all retail segments, AGA members are directly affected by the Commission's rules and policies addressing or affecting pipeline rates. AGA member companies, therefore, have a direct and substantial interest in the issues raised in this filing.

APGA is the trade association for approximately 1,000 communities across the U.S. that own and operate their retail natural gas distribution entities. They include municipal gas distribution systems, public utility districts, county districts, and other public agencies, all locally accountable to the citizens they serve. Public gas systems provide safe, reliable, and affordable energy to their customers and support their communities by delivering fuel to be used for cooking, clothes drying, and space and water heating, as well as for various commercial and industrial applications.

PGC is a trade association that represents energy-intensive large industrial and manufacturing natural gas consumers who are typically longstanding, significant employers within their respective communities. PGC members own and operate hundreds of manufacturing plants and facilities in virtually every state in the nation and consume natural gas delivered through interstate natural gas pipeline systems throughout the United States. PGC members hold transportation capacity on numerous interstate pipelines.

NGSA represents integrated and independent energy companies that produce and market domestic natural gas and is the only national trade association that solely focuses on producer-marketer issues related to the downstream natural gas industry. NGSA's members trade, transact, and invest in the United States natural gas market in a range of different manners as well as supply and ship billions of cubic feet of natural gas per day on interstate pipelines and therefore, could be greatly impacted by the outcome of this proceeding.

III. REQUEST FOR RULEMAKING

Petitioners request that the Commission initiate a rulemaking to consider evidence that new regulations are needed to prevent interstate natural gas pipelines from continuing the practice of (i) packaging operationally unrelated, non-contiguous segments of capacity in open seasons and (ii) allocating capacity based on a formula that includes the aggregate bids for both packages. Petitioners submit that this practice results in unjust and unreasonable rates, distorts market pricing, removes the incentive for pipelines to build more capacity where needed, constitutes illegal tying which effectively denies many parties access to needed capacity and, as a practical matter, results in undue discrimination against industrial gas consumers, municipal gas systems and local distribution utilities, and higher prices for the ultimate gas consumers.

A. New evidence demonstrates that widespread adoption of the practice of tying bids on non-contiguous segments of capacity in a single auction has resulted in harm to shippers and supports the need for FERC to adopt rules to prohibit this practice.

The Commission historically rejected proposals to tie non-contiguous segments of capacity into a single package for auctions, capacity allocations and rights of first refusal.[1] In a *Northern Border* order, the Commission approved a tariff that allowed the practice of tying bids on non-contiguous segments of capacity in auctions, for purposes of determining the Net Present Value (”NPV”) and awarding capacity.[2] Specifically, the Commission allowed the pipeline to award capacity to the bid generating the greatest NPV by aggregating bids on more than one segment of capacity to determine which combination of bids produces the highest NPV.[3] Shippers objected to the practice, but the Commission cited its prior decision in *Indicated Shippers v. Natural Gas Pipeline of America* (“*Indicated Shippers*"),[4] and held that its policy “permits packaging different

[1] *See Natural Gas Pipeline of America*, 82 FERC ¶61,036 at 61,140 (1998). (“The Commission agrees with the Indicated Shippers that Natural should not be able to post and require bidding on noncontiguous segments of capacity.”) The Commission noted that in an analogous situation in *Williams Natural Gas Company,* the Commission directed WNG to remove similar language in the context of right of first refusal procedures; specifically, the Commission directed WNG “to remove all language in its proposed tariff that would allow WNG to consider other offers to purchase other, unrelated capacity, when evaluating the net present value of offers. Such provisions are highly inappropriate.” *Id.* (*citing Williams Natural Gas Company*, 62 FERC ¶ 61,261 at 62,760 (1993) (“*Williams*”)). In approving a later settlement in that case, Natural agreed that it could not require bidding on non-contiguous pipeline segments and the Commission found that while nothing prevented Natural from posting non-contiguous capacity segments or auctioning capacity on such segments on a stand-alone basis, nothing in the tariff or the settlement appears to permit the bundling of non-contiguous capacity for auction. *See Natural Gas Pipeline Company of America*, 85 FERC ¶ 61,202 at 61,839 (1998).

[2] *See Northern Border Pipeline*, 164 FERC ¶ 61,150 at P 23 (2018) (“*Northern Border*”).

[3] *Id.* at P 3 (approving proposed tariff Section 6.26.4 which “provides that for the purposes of its NPV evaluation and as defined in the posting, Northern Border may aggregate two or more bids for one or more bid packages…”).

[4] *Id.* at P 22-23 (emphasis added) (citing *Indicated Shippers v. Natural Gas Pipeline Company of America*, 89 FERC ¶ 61,12 at 61,417 (1999), *reh'g denied,* 89 FERC ¶ 61,264 (1999) (“*Indicated Shippers*”)). In the

capacity segments and firm services so long as shippers are not **required** to bid on segments of capacity that are not desired...".[5] Furthermore, the Commission in *Northern Border* stated that it approved the tariff based on the expectation that this practice would benefit customers in future rate cases.[6] To the contrary, however, Petitioners' experience in recent years is that the practice is being implemented in a manner that is harmful to shippers, ratepayers, and the market.

As discussed below, Petitioners' experience in recent years demonstrates that even when the shippers are not technically required to bid on unwanted segments of capacity by the terms of the auction, they are effectively required to bid on unwanted segments of capacity to obtain needed capacity in these auctions. (*See*, *e.g.*, Affidavit of Michael J. Frey, attached as Exhibit No. 0001, at para. 6-7; Testimony of Terry Lewandowski, attached as Exhibit No. 0002 at page 2, lines 4-17; Affidavit of Mollie Giem, attached as Exhibit No. 0003 at page 4; Prepared Direct Testimony of George E. Briden, PHD, attached as Exhibit No. 0004 at pages 11-12). Therefore, this practice is causing harm to shippers who are effectively forced to bid over maximum rates for capacity that

Indicated Shippers case, the Commission found that the fact that Natural posted a pre-arranged deal as a package is not contrary to its tariff, and found that it was not required to post individual prices for each segment of capacity as long as it posted a reserve price for the package and that Natural was required to accept aggregate bids for such capacity if they resulted in a higher NPV than the prearranged agreement, noting that Natural stood ready to accept recourse bids for any portion of the auctioned capacity. On rehearing, in response to concerns about monopoly power, the Commission emphasized that Natural's capacity was not constrained and the negotiated rate bidder was bidding far below the NPV of the maximum rates. 89 FERC at 61,768.

[5] *Id.* at P 23 ("…the Commission's policy does not preclude a pipeline from packaging non-contiguous segments of capacity, so long as shippers are not required to bid on segments of capacity that are not desired and thus have an opportunity to obtain the portion of the capacity that they seek, understanding, of course, that a competing shipper willing to bid on all elements of the aggregated package may provide a greater NPV and become the winning bid.").

[6] *Id.* at P 24 ("maximizing revenue and the use of pipeline capacity will benefit all customers by increasing billing determinants and thereby lowering the unit fixed rate costs in the next case. The maximum recourse rate remains applicable to each segment of capacity included in the capacity offering, and thus shippers cannot be required to pay more than the maximum recourse rate for the capacity that they obtain.").

they require to serve their customers or to run their plants, and raises the same market power concerns that are raised by sellers acting in violation of the tying prohibition in anti-trust law.[7]

The evidence indicates that pipelines are packaging non-contiguous segments of capacity that are not operationally related and often have mismatched terms and volumes as a means to extract higher profits without any corresponding benefit to shippers. Petitioners submit the attached Appendix A as evidence, which includes a sample of auction postings over the past two years and demonstrates the increasing number of pipelines implementing this approach. As demonstrated in Appendix A, some of the capacity releases discussed involve: (1) packaging of capacity with delivery points into Chicago in the winter (highly desirable and valuable) with a much larger volume of capacity originating in Chicago with delivery points into markets in Michigan, against the normal direction of flow of supply in the winter (less desirable),[8] (2) packaging of capacity that flows in opposite directions at the same time on the same pipeline (forward haul highly valuable and backhaul unusable),[9] (3) packaging of capacity from a producing area to constrained markets in the Northeast (highly desirable and valuable) with a larger

[7] Tying arrangements are subject to Section 1 of the Sherman Act and raise anti-trust concerns because they may force consumers to buy a product or service that they simply do not want or need and are forbidden on the theory that, if the seller has market power, it can leverage its power through tying arrangements. *See*, *e.g.*, *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2 at 9 (1984). Pipeline transportation is a regulated monopoly service and pipelines should not be allowed to force buyers into purchases of pipeline capacity they do not want to obtain the capacity they need so they can extract monopoly rents.

[8] See example in Appendix A, ANR pipeline posting March 1, 2021, Segment 1 transportation from ML-7 receipt points and ANRPL storage to Chicago area deliveries and ANR Joliet Hub from 11/1/21-3/1/22 and quantity is up to 35,000 Dth/d. Segment 2 is from ANR Joliet Hub to ANRPL storage during the period from 1/1/22 to 3/31/22 and quantity is up to 100,000 Dth/d.

[9] See example in Appendix A, Northern Border posting July 17, 2018, Segment 1 transportation path from Port of Morgan (Receipt) to North Hayden (Delivery), Segment 2 from Kurtz (Bison Pipeline Interconnect (Receipt) to Port of Morgan (Delivery) and map showing the back and forward haul capacity overlapping. At the time, TransCanada Pipelines indicated no gas was flowing on Bison.

volume of capacity between two points in the Mobile Bay, Alabama region (less desirable)[10] and (4) packaging of capacity with different terms and different quantities.[11] In these situations, it is often impossible for a shipper to use one segment of capacity with the other segment (*i.e.*, flows in opposite directions on the same segment of pipeline), and it is inherently obvious that the packages are tied solely to increase the price that the pipeline can obtain for the valuable capacity, not to provide any benefit to the customer or indirectly to other shippers. Despite the fact that the tariff does not require the shipper to bid on multiple segments of capacity, Petitioners' experience (as demonstrated in the attached shipper affidavits) is that, as a practical matter, if the shipper does not bid on multiple segments, it will not have the highest NPV and will therefore lose the desired segment. (*See*, *e.g.*, Exhibit No. 0001, at para. 6; Exhibit No. 0002 at page 2, lines 4-9; Exhibit No. 0003 at pages 3-7; Exhibit No. 0004 at page 12, lines 6-10). This is so because many pipeline customers that have large enough credit capability will eagerly bid an aggregate amount for both the valuable and less desirable capacity that is a large percentage of the hedge-able spread on the valuable piece. If successful, such a bid will lock in a modest profit for the bidder. Customers

[10] See example in Appendix A, Transco posting December 9, 2020, Segment 1 transportation from Station 85 (zone 4) in Mississippi/Alabama to Station 165 (zone 5) in Virginia for a quantity of up to 25,000 dekatherms/ per day. Segment 2 is from Zone 4B in Alabama to Zone 4B in Alabama for a quantity of up to 150,000 dekatherms/day. See also example in Appendix A. Transco posting February 18, 2020, Segment 1 transportation from Marc I Interconnect on Leidy Line to Pooling Station 210 (from producing area/storage area in PA to market zone in NJ) for 75,000 dekatherms/day, Segment 2 is from Zone 4B in Alabama to Zone 4B in Alabama for a quantity of up to 175,000 dekatherms/day.

[11] See examples in Appendix A, Tennessee Gas Pipeline Oct. 24, 2018 Open Season #1189, Segment 1 has a term from 11/1/2019 - 3/31/2020, Segment 2 has a term from 1/1/2019 – 6/30/2019, and Segment 3 has a term from 1/1/2019 – 5/31/2019; Tennessee Gas Pipeline Sept. 26, 2018 Open Season #1291, Segment 1 has a term from 11/1/2021 - 3/31/2022, Segments 2 and 3 have a term from 3/1/2021 – 12/31/2021; Tennessee Gas Pipeline Sept. 26, 2018 Open Season #1184, Segment 1 has a term from 11/1/2019 - 3/31/2020, Segment 2 has a term from 1/1/2019 – 12/31/2019; Transco September 9, 2021 Open Season, Segment 1 has a term from 12/1/2021 - 2/28/2022, Segment 2 has a term from 12/1/2021 – 5/31/2021; ANR March 1, 2021 Open Season, Segment 1 has a term from 11/1/2021 - 3/31/2022, Segment 2 has a term from 1/1/2022 – 3/31/2022; Northern Border Feb. 16, 2018 Open Season #1750, Segment 1 has a term from 6/1/2018 - 3/31/2019, Segment 2 has a term from 4/1/2018 – 12/31/2018.

with an operational need for a particular segment of capacity to serve LDC load or a power plant or a manufacturing facility must compete on price to win the capacity they need. As such, the evidence supports a finding that the shipper effectively is **required** to bid on capacity it does not want or is virtually guaranteed to lose the capacity that it may require to fulfill its market commitments. As demonstrated further below, this practice of awarding capacity discriminates against certain shippers who do not have the resources to bid for capacity that they cannot utilize (*See, e.g.*, Exhibit No. 0002 at page 2, lines 10-17), and harms other shippers as they are forced to pay for capacity that they do not need, and cannot use, in order to obtain any portion of the needed capacity (*See, e.g.*, Exhibit No. 0003 at para. 4).

B. The Commission's rationale for precluding tying of capacity releases on the secondary market applies equally to the tying of bids in the primary market.

In the secondary market for capacity releases, the Commission has a prohibition against tying capacity to any extrinsic condition.[12] However, the Commission has made limited exceptions where the replacement shipper may need both packages because they are only valuable together (*i.e.*, transport into storage tied with storage capacity in a single release).[13] FERC's reasoning for prohibiting tying in the secondary capacity release market applies equally to pipelines tying bids for non-contiguous packages of capacity in a single auction.

[12] *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, 57 Fed. Reg. 13,267 (April 16, 1992), FERC Stats. and Regs., Regulations Preambles (January 1991 - June 1996) ¶ 30,939 at 30,446-48 (April 8, 1992); *order on reh'g,* Order No. 636-A, 57 Fed. Reg. 36,128 (August 12, 1992), FERC Stats. and Regs., Regulations Preambles (January 1991 - June 1996) ¶ 30,950 (August 3, 1992), *order on reh'g*, Order No. 636-B, 57 Fed. Reg. 57,911 (December 8, 1992), 61 FERC ¶ 61,272 (1992), *order on reh'g,* 62 FERC ¶ 61,007 (1993), *aff'd in part and remanded in part, United Distribution Companies v. FERC*, 88 F.3d 1105 (D.C. Cir. 1996), *order on remand,* Order No. 636-C, 78 FERC ¶ 61,186 (1997).

[13] *See Promotion of a More Efficient Capacity Release Market,* Order No. 712, 123 FERC ¶ 61,286 at n. 17 at P 190 (2008).

In addition to ensuring that sellers do not exercise monopoly power similar to the prohibition against tying embedded in anti-trust law, the capacity release tying prohibition was adopted by the Commission to prevent a releasing shipper from requiring a replacement shipper to pay for added capacity or services that they do not need. This prohibition prevents the releasing shipper from obtaining a payment for the released capacity at a rate above the maximum rate and also prevents the releasing shipper from forcing the replacement shipper to take unwanted capacity or services.[14] In an auction combining bids for two contiguous segments of capacity, each segment merits a valid bid because together they create a valuable path, and the capacity is generally awarded based on the calculation of the bid or combination of bids that result in the highest NPV for the pipeline, consistent with FERC policy.[15] The harm to shippers arises when the tied capacity bids are for segments that are non-contiguous, and one of the capacity segments is valuable (*i.e.*, highly desirable capacity) while the other is not (*i.e.*, less desirable capacity). The practical result of pairing valuable capacity in an auction with capacity that has little to no value is that shippers are effectively forced to bid on both segments to achieve a winning NPV. As demonstrated in the

[14] *See Transwestern Pipeline Co*., 92 FERC ¶ 61,035 (2000), in which FERC rejected the request for a tying waiver explaining that its policy against tying is meant to prevent pipelines from requiring shippers to take capacity that the shippers do not want in order to get capacity that the shippers do want. However, the Commission found that there was no tying where a pipeline increased capacity on the lateral that restored capacity on the mainline and posted the capacity together. The Commission noted the pipeline had significant turned back capacity and that, pursuant to a settlement, the pipeline absorbed 50% of the turned back capacity but was allowed to recoup some revenues through the expansion, and that shippers were able to request the increment of capacity they desired. 92 FERC at 61,180. *See also Louis Dreyfus Energy Services,* L.P., 114 FERC ¶ 61,246 at P 20 (2006). The Commission found that Louis Dreyfus Energy Services proposed to tie its gas sales contracts to its release of capacity and explained the Commission's prohibition against tying release of capacity to any other compensation paid to releasing shippers. *id*.

[15] *See Tennessee Gas Pipeline Co*., 79 FERC ¶ 61,297 at 62,337 (1997) (in accepting Tennessee's tariff proposing to award capacity based on NPV, the Commission stated"[t]o apply the NPV criteria is to allocate that capacity to the entity that values it the most, and this is consistent with Commission policy. The Commission has previously discussed the desirability of the economic efficiency achieved by allocating capacity to parties who value it most." (*citing* Order No. 636-A, FERC Statutes and Regulations ¶ 30,950 at 30,555)).

affidavits attached, industrial shippers and some retail distribution companies do not have the capability to bid on segments of capacity that cannot be used to serve their plants or customers in order to be awarded the capacity segment that they need. (*See, e.g.*, Exhibit No. 0001 at para. 6-7). Many shippers do not have enough credit capability (or authority in the case of regulated utilities) to bid on a large volume of tied capacity because of the risk of winning both and exceeding their credit limits.[16] As a result, they lose out to other shippers that are able to pay for less desirable, unwanted capacity in order to obtain the valuable capacity.

C. The evidence indicates that allowing pipelines to aggregate bids for non-contiguous capacity permits the exercise of market power and scarcity pricing contrary to Commission policy.

1. Commission Policy Prohibits Gas Pipelines from Exercising Market Power to Collect Scarcity Prices.

To prevent the inappropriate exercise of pipelines' inherent market power, FERC requires each pipeline to charge rates at or below a maximum rate cap approved by FERC. In Order No. 712, in discussing why the Commission removed the price caps on short-term releases in the secondary market but did not remove the price ceiling on pipelines in the primary market, the Commission stressed the importance of shippers having the option to purchase capacity at the recourse rate (*i.e.*, the maximum tariff rate) as a check on the ability of pipelines to exercise market power.[17] The Commission noted that, unlike releasing shippers, the pipeline holders of long-term

[16] In many cases, high-value, low-volume packages of capacity are paired with low-to-no-value, large volume packages of capacity.

[17] *See Promotion of a More Efficient Capacity Release Market,* Order No. 712, 123 FERC ¶ 61,286 at PP 82-86. *See also* Order No. 712-A, 125 FERC ¶ 61,216 (2008). FERC rejected calls from interstate pipelines to lift the maximum rate cap on short-term pipeline services stating, "it continues to find that maintenance of the maximum rate ceiling… is necessary to protect against the potential exercise of market power."

capacity have greater ability to exercise market power by withholding capacity and not constructing facilities.[18] The Commission added that because pipelines are in the best position to expand their own systems, cost-of-service rate ceilings help to ensure that pipelines have appropriate incentives to construct new facilities to alleviate constraints when needed. [19]

As the Commission found at that time, the only way that a pipeline would be able to create the requisite scarcity in order to force shippers to accept longer term contracts would be to refuse to build additional capacity when demand requires it.[20] In that circumstance, the Commission found that as long as cost-of-service rate ceilings apply, pipelines will have a greater incentive to build new capacity to serve all of the demand for their service than to withhold capacity. This is because the only way that a pipeline could increase current revenues and profits would be to invest in additional facilities to serve the increased demand. Similarly, the Commission concluded that as long as pipelines' short-term services are subject to a cost-of-service rate, the pipelines will not limit their construction of new capacity to meet demand in order to create scarcity that increases short-term prices. Indeed, the Commission concluded that releases at prices above the maximum rate will indicate that pipeline capacity is constrained and demonstrate that constructing additional

[18] Order No. 712, 123 FERC ¶ 61, 286 at P 85 ("unlike releasing shippers, the pipeline holders of primary capacity have a greater ability to exercise market power by withholding capacity and not constructing facilities.").

[19] *Id.*

[20] *Id.* (citing *Regulation of Short-Term Natural Gas Transportation Services,* 101 FERC ¶ 61,127 at P 12 (2002), *aff'd., American Gas Ass'n v. FERC*, 428 F.3d 255 (D.C. Cir. 2005)). *See also Tennessee Gas Pipeline Co. ("Tennessee")*, 91 FERC ¶ 61,053 (2000), *reh'g denied*, 94 FERC ¶ 61,097 (2001), *aff'd*, 292 F.3d 831 (D.C. Cir. 2002). In *Tennessee*, FERC recognized that Tennessee has market power with respect to the transportation of gas but decided that there is no need for a term-matching cap because there were sufficient controls to restrain Tennessee from withholding capacity to force shippers to bid longer terms. FERC held that because the pipeline cannot charge more than the maximum rate for existing capacity, it would not profit by withholding. The Commission also noted that the pipeline already has incentive to build new capacity to increase rate base and return, and, thereby, increase rates. 91 FERC at 61,191.

capacity could be profitable.[21] Pipelines are only permitted to enter negotiated rate agreements achieving a rate above cost-based, maximum recourse rates when shippers have access to the recourse rate in bidding for capacity, and when the agreements are filed with, and approved by, FERC.[22]

2. Petitioners submit information that indicates that the current practice allows pipelines to exercise market power to engage in scarcity pricing and effectively eliminates the recourse rate as a constraint on market power.

Since 2019, Petitioners have been gathering information on the impact of the tariff practice used by pipelines of packaging non-contiguous capacity segments in open seasons, and allocating such capacity based on aggregated bids. As shown in Appendix A, the amount that successful bidders have paid to the pipeline for the package of non-contiguous capacity exceeds the maximum rate that the pipeline could have charged for one segment of capacity alone. This excess payment is often equal to a large portion of the amount of the differential between the cost-based recourse rate for the valuable segment of capacity, and the market value of the same segment of capacity[23] during a time of scarcity and does not reflect the unwanted segment(s) of capacity suddenly becoming more valuable. This practice effectively enables the pipeline to collect a scarcity price

[21] *Id.*

[22] *Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines,* 74 FERC ¶ 61,076 at 61,238-242, *order on clarification,* 74 FERC ¶ 61,194, *order on reh'g*, 75 FERC ¶ 61,024 (1996). The Commission determined that the availability of the recourse rate would prevent pipelines from exercising market power by assuring that the customer always has the option of purchasing capacity at the just and reasonable tariff rate if the pipeline unilaterally demands excessive prices. *See also Tennessee Gas Pipeline Co.,* 91 FERC ¶ 61,053 (2000), *order on reh'g*, 94 FERC ¶ 61,097 (2001), *aff'd, Process Gas Consumers Group v. FERC,* 292 F.3d 831 (D.C. Cir. 2002). Moreover, in Order No. 637-A, the Commission reaffirmed its position that the recourse rate effectively mitigates pipeline market power by stating that "[T]he requirement that a pipeline sell its capacity at the regulated maximum rate prevents tacit collusion between the pipeline and the shipper to withhold capacity to raise price above the ceiling…"

[23] The difference in the price of gas at the receipt point into the capacity and the price of gas delivery point out of the capacity, *i.e.*, the basis or spread.

for the valuable segment of capacity (by assigning the differential to the segment(s) of capacity with little or no value), resulting in unjust and unreasonable rates for such capacity. By doing so, pipelines are effectively receiving a market-based rate without Commission approval to charge market-based rates. Additionally, as a result of this practice, these pipelines are not incentivized to build additional capacity that would be valuable to customers, contrary to Commission policy. (*See, e.g.*, Exhibit No. 004, page 11, lines 8-18). Instead, pipelines are incentivized to creatively package non-contiguous segments of capacity for the sole purpose of extracting monopoly rents from shippers.

One capacity auction by Transco, a long-haul pipeline extending from the Gulf of Mexico to the Northeast, is a prime example. The pipeline's posting included both a valuable capacity segment running north from Station 4 in Mississippi and Alabama to Zone 5 in the market area in the Mid-Atlantic in the winter (*i.e.*, highly desirable capacity), and a capacity segment in the South end of the pipeline going from Mobile Bay Station Zone 4A in Alabama to Zone 4B in Alabama (*i.e.*, less desirable capacity). The pipeline indicated it would not accept any bid for any package that is less than the full contract path or less than the full time period, and that NPV of each package bid by any party would be summed to determine the best bid. As shown in the example, the maximum recourse rate for the valuable capacity segment was $557,000. However, the capacity was awarded to a bidder that bid, in aggregate, $1,669,000, effectively representing the full $557,000 max rate value for the valuable segment and an additional $1,112,000. The market value on the invaluable segment was zero, and the aggregate bid of $1,669,000 compares to the market value on the valuable path, for that quantity of capacity. The effective winning bid for the valuable capacity was therefore over twice the amount of a bid at the maximum recourse rate. Additionally, as noted in the affidavit of Mollie Giem, the lack of value of the unwanted capacity is demonstrated by the fact that the winning bidder never even used the capacity. (*See* Exhibit No. 0003 at para. 4).

As explained in Order No. 712, pipelines have the ability to enter into negotiated rate agreements above the maximum tariff rate so long as the customer has the alternative of the recourse tariff rate to protect against monopoly pricing, and that rate is submitted to the Commission for review and approval prior to becoming effective.[24] Negotiated rate agreements are typically entered by shippers to provide rate certainty over the longer-term for a single piece of capacity versus these often shorter-term tied transactions that involve multiple packages of capacity. The pipeline may also seek market-based rates by making a filing with the Commission establishing that they lack market power in the markets that they serve. In addition, pipelines have the ability to propose seasonal rates for their systems, and therefore recover more of their annual revenue requirement in peak seasons.[25] Thus, pipelines have other opportunities for maximizing revenues that still protect consumers.

3. The current practice is unjust and unreasonable because it unduly discriminates against consumers who are not able to bid on unwanted capacity in order to obtain capacity that they need.

Petitioners present evidence in the attached affidavits that even when a pipeline's tariff does not mandate that a shipper submit bids on multiple segments of capacity, shippers are effectively required to do so because if they do not, they will lose the capacity that they need to other shippers who may not value both segments of capacity but can afford to submit a higher, above market bid for the entire package. (*See e.g.*, attached affidavit from Mollie Giem at pages 1-3, indicating that this customer bid above market for unwanted capacity in order to obtain wanted

[24] *See* Order No. 712 at P 86.

[25] *Id.*

capacity). Petitioners submit that shippers, such as industrial shippers and retail gas systems, do not benefit from this practice as they are not in a position to speculate on capacity that they do not need in order to receive capacity that they need. For example, a company that wants valuable pipeline capacity into Chicago to serve its plant cannot also bid on a segment of capacity that it does not need in Michigan in order to win the Chicago capacity. While the practice of tying packages of capacity together in a single open season does maximize the revenues to the pipeline, it does not benefit the shipper who effectively had no real opportunity to acquire the valuable capacity needed to serve its plant. Similarly, an LDC could not bid on both packages without subjecting itself to potential prudence review from state regulators for purchasing pipeline capacity that is not used and useful to serve its customers. Because this evidence contradicts the expectations that the Commission expressed in approving this practice historically, Petitioners request a rulemaking so that the Commission might consider new evidence to decide whether new regulations preventing or limiting this practice are in the public interest due to the discriminatory results to-date.

4. As existing pipeline customers, Petitioners assert that the current practice has not provided a benefit to shippers in pipeline rate cases.

In past cases, the Commission allowed pipelines to structure an open season to use NPV to maximize the use of the pipeline and revenues because this practice ensures that capacity will go to the shipper who values it most and results in the least unsubscribed capacity, thus benefiting the pipeline and all customers, including existing customers.[26] The Commission assumed that

[26] *See Tennessee Gas Pipeline Co.* 79 FERC ¶ 61,297 (1997) (stating "[t]o apply the NPV criteria is to allocate that capacity to the entity that values if the most, and this is consistent with Commission policy. The Commission has previously discussed the desirability of the economic efficiency achieved by allocating capacity to parties who value it most") (citing Order No. 636-A, FERC Statutes and Regulations ¶ 30,950 at 30,555).

customers would benefit because the pipelines' revenues are increased and thus, presumably, the pipeline will pass on these benefits to customers in the next rate case. Petitioners assert that as shippers on these pipelines, any purported benefit is marginal at best when pipelines charge above maximum rates for these aggregated capacity packages. Instead, such capacity that is awarded is considered as part of a single short-term transaction. Pipelines are able to select the base period for their rate cases. Pipelines can avoid engaging in these short-term transactions during the base period of the rate case so as not to increase overall billing determinants, which are generally set based on the actual experience in the 12-month base period and adjustments that are known and measurable during the test period. To the extent that they do enter these short-term transactions, pipelines often assert such revenues should not be reflected in the overall billing determinants or used to reduce calculated rates because they are not expecting to have the same level of revenues from such transactions in the future.

5. Petitioners request a rulemaking to consider a complete ban tying non-contiguous capacity segments.

Petitioners submit that the practice of allowing pipelines to package valuable and unwanted, operationally unrelated, non-contiguous capacity segments and to allocate the valuable capacity based on aggregated bids should be prohibited in the future for the reasons discussed above. In most, if not all, examples of inappropriate tying that the Petitioners have become aware of, the valuable capacity segment was not publicly posted as available on a pipeline electronic bulletin board prior to being included in an open season notice. Rather, the first notice the market received of the potential availability of the valuable capacity was when the pipeline issued an open season notice inviting bids on the valuable capacity combined with other, unwanted, non-valuable capacity. Petitioners understand that increments of capacity sometime become available on pipelines due to ambient conditions, improved capacity modeling, turnbacks or other changes. An alternative solution to outright prohibition of the tying described in this petition would be a requirement that any firm pipeline capacity first be posted for a reasonable period of time for bid, without any other capacity tied to it, before being included by the pipeline in an open season in which the valuable capacity is tied with other capacity. In this manner, transparency alone would allow the market to bid on newly discovered capacity segments at prices up to the recourse rate, prior to the pipeline being allowed to experiment with package offerings that create the concerns described in this Petition.

While customers recognize that with the requested prohibition on packaging of non-contiguous segments of capacity in open seasons, there may be situations where all bidders bid the maximum rate and the pipeline will be required to pro-rate the capacity, Petitioners submit that as customers with obligations to run industrial plants and serve load, it would be preferable to receive a *pro rata* allocation of capacity than none at all. In the event that capacity is being pro-rated, market forces would also have the opportunity to work properly to incentivize investment in capacity expansion, rather than incentivizing pipelines to avoid expansion in order to capture monopoly rents from captive customers.

IV. DOCUMENTS SUBMITTED WITH THIS PETITION

As mentioned above, Petitions have included the following supporting documents with this Petition:

A. Appendix A: Illustrative Open Season and Capacity Auction Postings

B. Exhibit No. 0001: Affidavit of Michael J. Frey

C. Exhibit No. 0002: Testimony of Terry Lewandowski

D. Exhibit No. 0003: Affidavit of Molly Giem

E. Exhibit No. 0004: Prepared Direct Testimony of George E. Briden, PH.D.

V. CONCLUSION

For the reasons stated above, Petitioners respectfully request that the Commission initiate a rulemaking on this matter.

Respectfully submitted,

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