34. From the Commission's Home Page on the Internet, this information is available in its eLibrary. The full text of this document is available in the eLibrary both in PDF and Microsoft Word format for viewing, printing, and/or downloading. To access this document in eLibrary, type the docket number of this document, excluding the last three digits, in the docket number field.

35. User assistance is available for eLibrary and the Commission's Web site during normal business hours. For assistance contact FERC Online Support at *FERCOnlineSupport@ferc.gov* or toll-free at (866)208–3676, or for TTY, contact (202) 502–8659. E–Mail the Public Reference Room at *public.referenceroom@ferc.gov* or (202) 502–8371.

By direction of the Commission.

Linda Mitry,

Deputy Secretary.

[FR Doc. 05–11530 Filed 6–13–05; 8:45 am]

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DEPARTMENT OF ENERGY

Federal Energy Regulatory Commission

18 CFR Part 284

[Docket No. RM05–2–000]

Order Reaffirming Discount Policy and Terminating Rulemaking Proceeding

June 7, 2005.

AGENCY: Federal Energy Regulatory Commission.

ACTION: Order Reaffirming Discount Policy and Terminating Rulemaking Proceeding.

SUMMARY: On November 22, 2004, the Federal Energy Regulatory Commission (Commission) issued a Notice of Inquiry (NOI) seeking comments on its policy regarding selective discounting by natural gas pipeline companies. The Commission has determined that it will take no further action in this proceeding and, therefore, it terminated Docket No. RM05–2–000.

DATES: The termination of this docket is made on June 14, 2005.

FOR FURTHER INFORMATION CONTACT: Ingrid Olson, Office of the General Counsel, Federal Energy Regulatory Commission, 888 First Street, NE., Washington, DC 20426; (202) 502–8406. *ingrid.olson@ferc.gov*

SUPPLEMENTARY INFORMATION:

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

Policy for Selective Discounting by Natural Gas Pipelines

Issued May 31, 2005

1. On November 22, 2004, the Commission issued a Notice of Inquiry (NOI) seeking comments on its policy regarding selective discounting by natural gas pipeline companies.[1] The Commission asked parties to submit comments and respond to specific inquiries regarding whether the Commission's practice of permitting pipelines to adjust their ratemaking throughput downward in rate cases to reflect discounts given by pipelines for competitive reasons is appropriate when the discount is given to meet competition from another natural gas pipeline. The Commission also sought comments on the impact of its policy on captive customers and on what changes to the policy could be considered to minimize any impact on captive customers. Comments and responses to the inquiries were filed by 40 parties.

2. As discussed below, after reviewing the comments, the Commission finds that its current policy on selective discounting is an integral and essential part of the Commission's policies furthering the goal of developing a competitive national natural gas transportation market. The Commission further finds that the selective discounting policy provides for safeguards to protect captive customers. If there are circumstances on a particular pipeline that may warrant special consideration or additional protections for captive customers, those issues can be considered in individual cases. This order is in the public interest because it promotes a competitive natural gas market and also protects the interests of captive customers.

Background

3. In the NOI, the Commission detailed the background and development of the selective discount policy. As explained in the NOI, in providing for open access transportation in Order No. 436, the Commission adopted regulations permitting pipelines to engage in selective discounting based on the varying demand elasticities of the pipeline's customers.[2] Under these regulations, the pipeline is permitted to discount, on a nondiscriminatory basis, in order to meet competition. For example, if a fuel-switchable shipper were able to obtain an alternate fuel at a cost less than the cost of gas including the transportation rate, the Commission's policy permits the pipeline to discount its rate to compete with the alternate fuel, and thus obtain additional throughput that otherwise would be lost to the pipeline. In Order No. 436, the Commission explained that these selective discounts would benefit all customers, including customers that did not receive the discounts, because the discounts would allow the pipeline to maximize throughput and thus spread its fixed costs across more units of service. The Commission further found that selective discounting would protect captive customers from rate increases that would otherwise ultimately occur if pipelines lost volumes through the inability to respond to competition.

4. Further, in the 1989 Rate Design Policy Statement,[3] the Commission held that if a pipeline grants a discount in order to meet competition, the pipeline is not required in its next rate case to design its rates based on the assumption that the discounted volumes would flow at the maximum rate, but may reduce the discounted volumes so that the pipeline will be able to recover its cost of service. The Commission explained that if a pipeline must assume that the previously discounted service will be priced at the maximum rate when it files a new rate case, there may be a disincentive to pipelines discounting their services in the future to capture marginal firm and interruptible business. In order to obtain a discount adjustment in a rate case, the pipeline has the ultimate burden of showing that its discounts were required to meet competition. The policy of permitting discount adjustments is consistent with the discussion of the court in *Associated Gas Distributors* v. *FERC (AGD I)*[4] suggesting that discount adjustments should be permitted.

5. In Order No. 636, the Commission began to move away from the monopolistic selective discounting model to a competitive model,

[1] 109 FERC ¶ 61,202 (2004).

[2] *See Regulations of Natural Gas Pipelines After Partial Wellhead Decontrol*, FERC Stats. & Regs., Regulations Preambles (1982–1985) ¶ 30,665 at 31,543–45 (1985).

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

[4] 824 F.2d 981, 1012 (D.C. Cir. 1987). As explained in the NOI, the court addressed an argument presented by some pipelines that the Commission's policy permitting pipelines to offer discounts to some customers, might lead to the pipelines under-recovering their costs. The court set forth a numerical example showing that the pipeline could under-recover its costs, if, in the next rate case after a pipeline obtained throughput by giving discounts, the Commission nevertheless designed the pipeline's rates based on the full amount of the discounted throughput, without any adjustment. However, the court found no reason to fear that the Commission would employ this ''dubious procedure,'' and accordingly rejected the pipelines' contention.

particularly for the secondary market. The institution of capacity release created competition between shippers and the pipeline with respect to unused capacity. Thus, competition from capacity release requires pipelines to discount their interruptible and short-term firm capacity.

6. Since *AGD I* and the Rate Design Policy Statement, the issue of ''gas-on-gas'' competition, *i.e.*, where the competition for the business is between pipelines as opposed to competition between gas and other fuels, has been raised in several Commission proceedings.[5] In these proceedings, certain parties have questioned the Commission's rationale for permitting selective discounting, *i.e.*, that it benefits captive customers by allowing fixed costs to be spread over more units of service. These parties have contended that, while this may be true where a discount is given to obtain a customer who would otherwise use an alternative fuel and not ship gas at all, it is not true where discounts are given to meet competition from other gas pipelines. In the latter situation, these parties have argued, gas-on-gas competition permits a customer who must use gas, but has access to more than one pipeline, to obtain a discount. But, if the two pipelines were prohibited from giving discounts when competing with one another, the customer would have to pay the maximum rate to one of the pipelines in order to obtain the gas it needs. This would reduce any discount adjustment and thus lower the rates paid by the captive customers.

7. In *Southern Natural Gas Co.*,[6] the Commission rejected the argument made by one of Southern's customers that no discount adjustment should be permitted with respect to gas-on-gas competition. The Commission stated, ''in light of the dynamic nature of the natural gas market, the Commission believes any effort to prohibit interstate gas pipelines from discounting to meet gas-on-gas competition would inevitably result in a loss of throughput to the detriment of all their customers.'' [7] The Commission explained that the pipeline faced competition from intrastate pipelines not subject to the Commission's jurisdiction, so that the Commission could not prohibit gas-on-gas competition altogether. The Commission also stated that discounts given to meet gas-on-gas competition are not readily distinguishable from discounts given to meet competition from alternative fuels. [8]

8. The NOI sought comments from the parties on the effect of the current policy on captive customers, whether the Commission should eliminate the discount adjustment for discounts to meet gas-on-gas competition, and whether the Commission should consider alternative policy choices to minimize any adverse effects on captive customers.

The Comments in Response to the NOI

9. The Commission received comments from 40 parties in response to the NOI. Comments in support of the Commission's current discount policies were filed by BP America Production Company and BP America Energy Company (BP America), Cinergy Services, Inc. (Cinergy), Discovery Gas Transmission (Discovery Gas), Dominion Resources Services, Inc. (Dominion), El Paso Corporation's Pipeline Group (El Paso), Enbridge Inc. and Enbridge Energy Partners (Enbridge), Florida Power & Light (Florida Power), Gas Transmission Northwest Corporation (Northwest), Gulf South Pipeline Co., L.P. (Gulf South), Iowa Utilities Board, Independent Petroleum Association of America (IPAA), Interstate Natural Gas Association of America (INGAA), Louisville Gas & Electric Company (Louisville Gas), Memphis Light, Gas and Water Division (Memphis Light), Michigan Consolidated Gas Company (Mich Con), MidAmerican Energy Co. (MidAmerican), Natural Gas Pipeline Co. of America (Natural), Natural Gas Supply Association (NGSA), Northern Natural Gas Co. (Northern), Texas Gas Transmission, LLC (Texas Gas), Nicor Gas, Process Gas Consumers Group and American Forest and Paper Products (Process Gas), Reliant Energy Services, Inc.(Reliant), Sempra Global Enterprises (Sempra), Southern California Gas Company and San Diego Gas & Electric Co. (SoCalGas and San Diego), Transcontinental Gas Pipeline Corp. (Transco), Williston Basin Interstate Pipeline Co. (Williston).

10. Generally, the parties supporting the current policy state that the policy has worked well, is central to the Commission's procompetitive policies, and sends appropriate price signals to the market. They argue that a discount adjustment for gas-on-gas competition is essential to competition in the secondary market. Further, they assert that there are safeguards that adequately protect captive customers.

11. In addition, several parties generally support the Commission's policy, but seek modifications of certain aspects of the policy. These parties are Calpine Corporation (Calpine), CenterPoint Energy Resources Corp. (CenterPoint), Memphis Light, Gas, and Water (Memphis Light), Missouri Public Service Commission (MoPSC), National Fuel Gas Distribution Corporation and Niagara Mohawk Power Corporation (National Fuel), and Northwest Industrial Gas Users (Northwest Industrials). The parties seek modification of the current policy with regard to the burden of proof on pipelines seeking a discount adjustment, discounts that result from competition with capacity release, discounts on expansion capacity, the need for pipelines to make periodic section 4 filings, and the adequacy of the information posted concerning the discounts.

12. On the other hand, comments opposing the Commission's policy were filed by the American Public Gas Association (APGA), Arizona Electric Power Cooperative, Inc. (Arizona Electric), Illinois Municipal Gas Agency (IMGA),[9] Northern Municipal Distributor Group and the Midwest Region Gas Task Force Association (Northern Municipals), National Association of State Utility Consumer Advocates (NASUCA), and the Commission's Office of Administrative Litigation (OAL).

13. Generally, the parties opposing the policy state that the Commission's rationale in support of the discount policy is flawed because it does not recognize that one pipeline's gain through discounting is another pipeline's loss and the policy does not provide net benefits to captive customers. Further, they assert that even if a discount produces an increase in throughput, that discount also contributes to increased wellhead prices. They assert that the current policy cannot be sustained unless the Commission finds substantial evidence that captive shippers on the competing pipelines obtain a net benefit from the

[5] The Illinois Municipal Gas Agency (IMGA) raised this issue in a petition for rulemaking in Docket No. RM97–7–000. In the NOI, the Commission stated that it would consider all comments on this issue in Docket No. RM05–2–000 and terminated the proceeding in Docket No. RM97–7–000. The Commission explained that the issues included in Docket No. RM05–2–000 include all the issues raised in the Docket No. RM97–7–000 proceeding. IMGA did not seek rehearing of the Commission's decision to terminate the Docket No. RM97–7–000 proceeding and did not in its comments object to the procedural forum offered to it in Docket No. RM05–2–000.

[6] 67 FERC ¶ 61,155 (1994).

[7] *Id.* at 61,458.

[8] For a more detailed discussion of the background of the Commission's selective discount policy, see the NOI at P 2–10.

[9] IMGA also filed a responding affidavit. The NOI did not provide for reply comments and no other party filed a reply. In these circumstances, the Commission will not consider IMGA's response.

throughput adjustment. The issues raised by the parties are discussed below.

Discussion

14. After considering the comments filed in response to the NOI, the Commission has determined not to modify its current policies concerning selective discounting. Therefore, the Commission will continue to allow a pipeline to seek a reduction in the volumes used to design its maximum rates, if it obtained those volumes by offering discounts to meet competition, regardless of the source of that competition. As the Commission stated in Order No. 636:

> The Commission's responsibility under the NGA is to protect the consumers of natural gas from the exercise of monopoly power by the pipeline in order to ensure consumers ''access to an adequate supply of gas at a reasonable price.'' [*Tejas Power Corp.* v. *FERC*, 908 F.2d 998, 1003 (D.C. Cir. 1990).] This mission must be undertaken by balancing the interests of the investors in the pipeline, to be compensated for the risks they have assumed, and the interests of consumers, and in light of current economic, regulatory, and market realities.[10]

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

A. Discount Adjustments Associated With Gas-on-Gas Competition

15. APGA, IMGA, NASUCA, Northern Municipals, Arizona Electric Cooperative, and OAL assert that the Commission should revise its discount policy so as to eliminate any adjustment to rate design volumes for discounts given to meet competition from other transporters of natural gas (which we will refer to as gas-on-gas competition). They point out that the Commission's rationale for permitting selective discounts is that discounts benefit all customers, including captive customers that did not receive the discounts, because the discounts allow the pipeline to maximize throughput and thus spread its fixed costs across more units of service. A discount adjustment is permitted in the pipeline's next rate case in order to avoid discouraging such beneficial discounts. These parties contend that, while this rationale may justify permitting an adjustment to rate design volumes for discounts given to obtain a customer who would otherwise use an alternative fuel and not ship gas at all, it is not true where discounts are given to meet competition from other gas transporters.

16. In the latter situation, these parties argue, gas-on-gas competition permits a customer who must use gas, but has access to more than one pipeline, to obtain a discount. These parties assert that such a discount does not produce an overall increase in pipeline throughput; it simply shifts throughput from one pipeline to another. As a result, they argue, discounts given to meet gas-on-gas competition provide no net benefit to captive customers as a class. In fact, captive customers would be better off if competing pipelines were discouraged from offering discounts in competition with one another, since then the throughput at issue would flow on one of the pipelines at the maximum rate rather than at a discounted rate. They conclude that such discounts should not be encouraged through the availability of a discount adjustment in the pipeline's next rate case. Rather, to the extent a pipeline may wish to give a discount in such circumstances, the pipeline and its shareholders should be required to absorb the cost of the discount.

17. The remaining commenters generally support continuing to allow an adjustment to rate design volumes for discounts given to meet gas-on-gas competition, although some commenters suggest other changes in Commission policy concerning discounts.

18. After reviewing all the comments, the Commission has concluded that, in today's dynamic natural gas market, any effort to discourage pipelines from offering discounts to meet gas-on-gas competition would do more harm than good. Accordingly, the Commission will not modify its policy to prohibit pipelines from seeking adjustments to their rate design volumes to account for discounts given to meet gas-on-gas competition. However, in individual rate cases, parties remain free to contend that, in the circumstances of the particular case, a full discount adjustment may be inequitable.[11]

19. Before explaining our reasons for reaching this conclusion, we first observe that pipelines face at least three separate categories of so-called gas-on-gas competition. One category is competition from other interstate pipelines subject to the Commission's NGA jurisdiction. The second category is competition from capacity releases by the pipeline's own firm customers. The third category is competition from intrastate pipelines not subject to the Commission's jurisdiction. The commenters opposing discount adjustments for gas-on-gas competition focus on the first two types of gas-on-gas competition. They generally recognize that the Commission has no ability to discourage intrastate pipelines outside the Commission's jurisdiction from offering discounts in competition with interstate pipelines and therefore interstate pipeline discounts to avoid loss of throughput to non-jurisdictional intrastate pipelines do benefit captive customers of the interstate pipelines. Therefore, our discussion below addresses only the first two types of gas-on-gas competition. Because the contentions of the parties and our reasons for allowing discount adjustments for discounts to meet competition from other interstate pipelines and discounts to meet competition from capacity release are different, we discuss the two separately below.

1. Competition From Other Interstate Pipelines

20. In the NOI, the Commission asked several questions concerning the extent to which interstate pipelines give discounts to meet competition from other interstate pipelines, including asking IMGA to explain the basis for its previous statements that over 75 percent of discounts are for this purpose. None of the commenters have provided responses that would enable the Commission to estimate with any precision what percentage of pipeline discounts are currently being given to meet competition from other interstate pipelines. For example, IMGA has clarified in its comments that its over 75 percent estimate is based solely on the testimony of its witness in Southern Natural Gas Company's section 4 rate case in Docket No. RP92–134–000. That testimony only analyzed the discounts given by Southern during the period May 1992 through April 1993.[12] Clearly, the discounting practices of one interstate pipeline over ten years ago are not probative as to the prevalence of gas-on-gas discounting by all interstate pipelines today.

21. Nevertheless, all commenters, whether they oppose or support allowing rate design volume adjustments for discounts to meet gas-on-gas competition from other interstate

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

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

[12] Affidavit of Baker Clay at 16, attached to IMGA's comments.

pipelines, appear to agree that such discounts are, in INGAA's words, ''widespread.'' [13] Thus, the Commission recognizes that such discounts make up a significant portion of pipeline discounts. It also appears that such discounts are more pervasive in some regions than others. For example, INGAA states that such discounts are pervasive in the production areas of East Texas, South Louisiana, and South Texas, as well as in the Midwest and the Western regions.

22. APGA, IMGA, NASUCA, Northern Municipals, Arizona Electric Cooperative, and OAL all contend that pipeline discounts given to meet competition from other interstate pipelines do not increase overall interstate pipeline throughput and therefore do not benefit captive customers. These commenters assert that the customers who obtain such discounts are larger LDCs, industrials, or electric generators who may have access to more than one interstate pipeline but who are not fuel switchable. These commenters thus assert that such customers would take the same amount of gas even if required to pay the maximum rate of whichever pipeline they choose to use. Based on that premise, these commenters assert that discounts resulting from competition between interstate pipelines serve only to reduce the revenue contribution of the customers receiving the discounts, thereby forcing captive customers without access to more than one pipeline to bear additional costs. In short, these commenters make the same contention the DC Circuit described in *AGD I*,[14] when it stated, ''It has long been contended * * * that rate differentials based exclusively on competition between transporters with similar cost functions may end up forcing captive customers to bear disproportionate shares of fixed costs without any offsetting gain in efficiency.''

23. However, the court followed the description of this contention with the statement, ''The contention is not self evidently true: if the demand of buyers with access to competing carriers is at all price elastic, the price reductions they enjoy will raise their demand close to competitive levels.'' [15] Based on the comments filed by the supporters of the Commission's current policy, the Commission finds that the demand of shippers with access to more then one interstate pipeline is sufficiently price elastic that discouraging discounts by competing interstate pipelines would do more harm than good.

24. It does not follow from the fact that a potential pipeline customer currently lacks the ability to use alternative fuels that its demand for gas is totally inelastic. Supporters of the current policy offer many examples of why this is so. Industrial and other business customers of pipelines, who account for over half of U.S. end-use gas consumption,[16] typically face considerable competition in their own markets and must keep their costs down in order to prosper. Lower energy costs achieved through obtaining discounted pipeline capacity can help them increase operations at their plants or at least minimize the possibility that such customers will outsource their production to other areas where their product can be produced at lower cost or simply close their plants due to an inability to compete.[17] For example Process Gas Consumers [18] stated, ''A plant may be able to increase output based on access to a competitive natural gas source on a competing pipeline but only if a transportation discount is given. In that case, a discount based on gas-on-gas competition will actually increase throughput instead of simply shifting throughput from one pipeline to another.'' Similarly, as BP America [19] states, ''Requiring generators to pay maximum rates might result in marginal generation costs exceeding the market price of power, forcing the generator to shut down.''

25. Discounts may also reduce the incentive for existing non-fuel switchable customers to install the necessary equipment to become fuel switchable.[20] In addition, potential new customers, such as companies considering the construction of gas-fired electric generators, may be more likely to build such generators if they obtain discounted capacity on the pipeline.[21] In all these situations a discount may cause the customer to contract for a greater amount of capacity on whichever pipeline they choose than they would have if the pipeline had not offered them a discount.

26. Commenters opposing discount adjustments for gas-on-gas competition also complain that larger LDCs may use their access to more than one pipeline to obtain discounts for capacity that, absent the willingness of the pipelines to offer discounts in competition with one another, the LDC would contract for at the maximum rate. LDCs in the business of distributing gas obviously do not have the option of switching to an alternative fuel. However, that does not mean that they would necessarily contract for the same amount of interstate pipeline capacity regardless of the price of that capacity. An LDC's need for interstate pipeline capacity depends upon the demand of the LDC's customers for gas, and that demand is elastic. LDCs typically have customers who are fuel switchable. They also have non-fuel switchable industrial or business customers whose gas usage may vary depending upon cost for the same reasons as the similar customers directly served by the pipelines discussed above. Moreover, LDCs may have the option of building more facilities of their own as a substitute for some of their interstate capacity.[22] Thus, a discount may cause such an LDC to contract for more firm capacity than it would have, if it had been unable to obtain discounted capacity on any pipeline.

27. Pipeline discounts may also enable natural gas producers to keep marginal wells in operation for a longer period and affect their decisions on whether to explore and drill for gas in certain areas with high production costs. For example, the Natural Gas Supply Association [23] stated, ''If forced to pay maximum tariff rates to move gas out of certain production areas, particularly offshore, or for marginal wells, in some circumstances this could impact development or even lead to premature abandonment of existing gas wells.'' Also, many producers sell gas under net-back arrangements, under which the price they receive for sale of the gas commodity is the market price for delivered gas in the consuming area minus the cost of transportation.[24] Thus, a higher cost of transportation translates into a lower price for the gas

[13] INGAA comments at 17. INGAA states gas-on-gas discounting is widespread, ''particularly when one takes into consideration'' competition from capacity release and non-jurisdictional pipelines. However, the Commission does not understand INGAA to dispute that a significant portion of pipeline discounts are given to meet competition from other interstate pipelines.

[14] 824 F.2d at 1011–2.

[15] *Id.* at 1012.

[16] As cited by BPAmerica at 12 Fn. 8, the Energy Information Administration (EIA) reports that non-human needs consumers account for about 60 percent of end-use consumption.

[17] Williston at 21–22; INGAA at 11 and the accompanying Henning Affidavit at 15; Natural at 19.

[18] *Id.* at 4.

[19] *Id.* at 12.

[20] Nicor at 5; INGAA, the accompanying Henning Affidavit at 18, Natural, Economic Analysis at 15.

[21] Reliant Energy Services, Inc. at 6; Gulf South at 28, INGAA, the accompanying Henning Affidavit at 18; Natural, Economic Analysis at 15.

[22] Nicor at 8. (''In a number of instances, Nicor Gas had found it more economical to use discounted capacity rather than to construct additional facilities.'').

[23] NGSA at 8. *See also* INGAA at 111–12, Henning Affidavit at 18, 22.

[24] IPAA at 4.

commodity, which may render some production activities uneconomic.[25] Therefore, once again a discount in this situation could lead to increased throughput.

28. Finally, on many pipeline systems, the bulk of the pipelines' discounts are given to obtain interruptible shippers. All interruptible shippers may reasonably be considered as demand elastic, regardless of whether they are fuel switchable. Their very choice to contract for interruptible service shows that they do not require guaranteed access to natural gas.[26] Otherwise, they would have purchased firm interstate pipeline capacity. Thus, absence of a discount could cause such a shipper to take less service or discontinue service altogether, since the shipper has already indicated it does not require service.

29. The Commission thus finds no basis to conclude that overall interstate pipeline throughput would remain at the same level, if the Commission discouraged interstate pipelines from giving discounts in competition with one another. Rather, it seems clear that such discounts do play a role in increasing throughput on interstate pipelines. The Commission thus rejects the fundamental premise of the commenters seeking to have the Commission disallow any discount adjustment in Natural Gas Act (NGA) section 4 rate cases for discounts given in competition with another interstate pipeline.

30. Apart from the issue of the extent to which such discounts increase overall throughput on interstate pipelines, the Commission finds that discounts arising from competition between interstate pipelines provide other substantial public benefits, which would be lost if the Commission sought to discourage such discounting. Such discounting leads to more efficient use of the interstate pipeline grid, by enabling pipelines to adjust the price of their capacity to match its market value. Any effort to discourage interstate pipelines from offering discounts when necessary to reduce their rates to the market value of their capacity would lead to harmful distortions in both the commodity and capacity markets.

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

32. The development of spot markets in downstream areas means there is now a market price for delivered gas in those markets. That price reflects not only the cost of the gas commodity but also the value of transportation service from the production area to the downstream market. The difference between the downstream delivered gas price and the market price at upstream market centers in the production area (referred to as the ''basis differential'') shows the market value of transportation service between those two points. As a result, ''gas commodity markets now determine the economic value of pipeline transportation services in many parts of the country. Thus, even as FERC has sought to isolate pipeline services from commodity sales, it is within the commodity markets that one can see revealed the true price for gas transportation.''[27] These basis differentials may vary on a daily and seasonal basis.

33. Discounting pipeline capacity to the market value indicated by the basis differentials provides greater efficiency in the production and distribution of gas across the pipeline grid, promoting optimal decisions concerning exploration for and production of the gas commodity and transportation of gas supplies to locations where it is needed the most. First, such discounting helps minimize the distorting effect of transportation costs on producer decisions concerning exploration and production. The various interstate pipelines competing in the same downstream markets may bring gas from different supply basins. For example, different interstate pipelines serving California are attached to supply basins in the Texas, Oklahoma, Gulf Coast area; the Rocky Mountain area, and Canada. Without discounts by the higher cost pipelines, producers in supply basins served by higher cost pipelines would generally face the burden of any price reductions necessary to meet the market price for delivered gas in the downstream areas.[28] As a result, gas reserves from supply areas served by lower cost pipelines would have a built-in cost advantage over gas reserves served by higher cost pipelines. Thus, lack of discounting could cause production of reserves served by higher cost pipelines to be delayed or reduced, even though those reserves might have similar or greater potential. This is inconsistent with the goal of ensuring consumers access to an adequate supply of gas at reasonable costs.

34. Second, if several interstate pipelines serve the same downstream market, discounting can help minimize short-term price spikes in response to increases in demand. In a situation where the maximum rate of the higher cost pipeline is greater than the basis differential between its supply area and the market area in question, then absent a discount adjustment, that pipeline may not be willing to transport additional supplies at a discount until the basis differential rises to its maximum rate. Thus, discouraging discounting by the higher cost pipeline could delay the supply increases in the downstream market necessary to moderate the price spike.[29]

35. Third, discounting also enables interstate pipelines with higher cost structures to compete with lower cost pipelines for customers, enabling the capacity of both pipelines to be utilized in the most efficient manner possible.[30] In the absence of such discounts, existing customers of the higher cost pipeline with access to the lower cost pipeline would likely switch to the lower cost pipeline to the extent it has available capacity. Similarly, new customers would contract first with the lower cost pipeline.[31] Fewer customers contributing to the fixed costs of the higher cost pipeline would lead to higher rates on that pipeline, to the detriment of its captive customers.[32] Moreover, the demand for service on the lower cost pipeline combined with increasing rates on the higher cost pipeline could trigger an expansion of the lower cost pipeline despite the existence of unused capacity on the higher cost pipeline, as long as the expansion could be priced at less than the higher cost pipeline's maximum

[25] Williston at 26 (''Pipeline revenues industry wide could fall significantly as some producers, particularly those with already low operating margins, shut their wells rather than transport gas to market at maximum rate.''); INGAA, Henning Affidavit at 22.

[26] Williston at 22.

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

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

[29] Duke Energy at 19.

[30] Sempra at 6; Nicor at 6; Gulf South at 34.

[31] Duke Energy at 27–28.

[32] Reliant Energy at 9.

rate. However, if the higher cost pipeline could discount, then an expansion would be unnecessary, and thereby lead to a more efficient result.

36. Fourth, discounting helps facilitate discretionary shipments of gas into storage during off-peak periods. Some marketers and others may only move gas into storage when existing seasonal prices and/or tradeable basis differentials allow them to hedge their financial risks. If pipelines are discouraged from discounting the price of their capacity to the seasonal basis differential, some customers may find it too risky to put gas into storage.[33] This may then lead to higher peak period gas costs, when the supply of gas in storage is lower than it otherwise would have been.

37. Finally, selective discounting helps pipelines more accurately assess when new construction is needed. When the basis differential between two points equals or exceeds the applicable maximum tariff rates for prolonged periods of time, that fact indicates a need for more capacity between those points. In contrast, basis differentials below maximum rates indicate additional capacity between the relevant points is not needed. Discouraging discounting would distort these price signals, since a high basis differential could simply be the result of the lack of discounting as opposed to an indication of a capacity constraint.[34] Moreover, it is only efficient to construct new pipeline facilities when the stand-alone cost of the new facilities is less than the incremental cost of serving the same customer using the facilities of an existing pipeline. However, if the existing pipeline is discouraged from discounting, the construction of new pipeline facilities could occur in selected locations where the stand-alone cost of the new pipeline is less than the embedded cost rate of an existing higher cost pipeline. Thus, discouraging existing pipelines from offering discounts in such situations could distort investment decisions.[35]

2. Competition From Capacity Release

38. APGA, National Fuel, NASUCA, Northern Municipals, and OAL oppose inclusion of a discount adjustment in pipeline rates for discounts that result from competition with the pipeline's own customers who are participating in capacity release. These parties argue that when pipelines receive a discount adjustment for discounts given in competition with capacity releases made by the pipeline's captive customers, the pipeline has a competitive advantage over the releasing shippers because the cost of the discount is subsidized by those same releasing shippers. They argue that to the extent the pipeline is able to sell this capacity by offering a discount, the releasing shipper is harmed by not being able to capture revenues from the release. NASUCA argues that if the shipper who is competing with the pipeline through attempts to release capacity is an LDC, retail consumers are doubly burdened, first, by the loss of the release revenues to offset high cost or stranded capacity and, second, in the payment of the subsidy for the discount given by the pipeline.

39. The goal of the Commission in creating the capacity release market in Order No. 636 was to create a robust secondary market for capacity where the pipeline's direct sale of its capacity must compete with its firm shipper's offers to release their capacity. Capacity release requires pipelines to discount, or suffer the loss of those sales.[36] Capacity release has made it more difficult for pipelines to obtain additional throughput through selective discounting. As the Commission explained in Order No. 636, capacity release reduces the pipeline's sale of interruptible service because potential purchasers of interruptible service would have the option of purchasing released firm capacity.

40. Further, as the court recognized in *INGAA* v. *FERC*,[37] the establishment in Order No. 636 of segmentation and flexible point rights was intended to enhance the value of firm capacity and promote competition in the secondary market between shippers releasing their capacity and pipelines, as well as between releasing shippers themselves. In Order No. 637, the Commission took additional actions to enhance flexibility and competition in the secondary market by requiring pipelines to permit a shipper to segment its capacity either for its own use or for the purpose of capacity release. This enhances shippers' ability to compete in the capacity release market by giving them the right to segment capacity and sell their capacity in separate packages.

41. The capacity release program together with the Commission's policies on segmentation, and flexible point rights, has been successful in creating a robust secondary market where pipelines must compete on price. To prevent pipelines from competing effectively in this market would defeat the purpose of capacity release and eliminate the competition that capacity release has created. Competition between the pipeline and its shippers will be stifled if the pipeline's ability to offer service at a price below the maximum rate is hampered by lack of a discount adjustment. Diminished competition in the secondary market will tend to raise prices to the detriment of all shippers.

42. Capacity release provides benefits to captive customers by allowing them to compete with the pipeline for the sale of their unused capacity. To the extent they are able to sell their unused capacity in the capacity release market at a discount, they will be able to offset a portion of their transportation costs. It is not unreasonable to require them to compete with the pipeline for the sale of this capacity, and the Commission has provided shippers with flexible point rights and the ability to segment their capacity to enhance their ability to compete in the secondary market. The releasing shipper has an additional competitive advantage over the pipeline because the capacity that is being released by the shipper is firm capacity, while the pipeline may be limited to offering interruptible service because it has already sold the capacity to the releasing shipper on a firm basis. Therefore, the service being released by the shipper has a higher value. Moreover, any discount adjustment received by the pipeline is not a subsidy, but simply gives the pipeline an opportunity to recover its costs, consistent with the court's admonition in AGD I[38] and is subject to review in the rate case.

3. The Discount Adjustment and Expansion Capacity

43. IMGA, NASUCA, Northern Municipals, and OAL argue that the Commission should modify its policy and disallow discount adjustments for discounts given on expansion capacity. These parties argue that permitting such

[33] BP America at 13.

[34] Gulf South at 18–19.

[35] Kinder Morgan, Declaration of David Sibley and Michael Doane at 16. Nicor at 4. Enbridge at 8.

[36] See Order No. 636–A, FERC Stats. & Regs ¶ 30,950 at 30,562; Order No. 636–B, 61 FERC ¶ 61,272 at 61,999.

[37] 285 F.3d 18, 36 (D.C. Cir. 2002).

[38] 824 F.2d 981, 1012 (D.C. Cir. 1987). In *AGD I*, the court addressed an argument presented by some pipelines that the Commission's selective discount policy might lead to the pipelines under-recovering their costs. The court set forth a numerical example showing that the pipeline could under-recover its costs, if, in the next rate case after a pipeline obtained throughput by giving discounts, the Commission nevertheless designed the pipeline's rates based on the full amount of the discounted throughput, without any adjustment. However, the court found no reason to fear that the Commission would employ this ''dubious procedure,'' and accordingly rejected the pipelines' contention.

a discount artificially reduces the true price of the new capacity, interferes with the workings of the market, and artificially influences the economic decisions made by those parties participating in the project. Further, they argue, there is no justification for requiring captive customers to subsidize new construction.

44. Moreover, these parties argue that permitting a discount adjustment for discounts on expansions is at odds with the Commission's policy concerning new projects which requires that they be incrementally priced where existing customers receive no benefits from the expansion project.[39] NASUCA states that the Commission adopted its pricing policy for expansion projects to send accurate price signals to market participants as to the cost of new capacity, and that discount adjustments would distort those price signals and essentially result in rolled-in rates if the difference between the discount and the actual cost of expansion projects were recovered in rates from pre-expansion, non-discounted shippers. IMGA states that in order for a pipeline to construct new facilities, there should be a market demand for those facilities and if a pipeline must discount expansion capacity in order to compete, the expansion is probably not necessary.

45. On the other hand, INGAA, Duke, El Paso, Reliant, Williston, BP America, CenterPoint, Louisville, MidAmerican, Nicor, SoCalGas and SDG&E, and Transco argue the selective discount policy should be applicable to expansions and that a prohibition against selective discounting would discourage pipeline expansions.

46. The Commission finds no basis for creating an exemption from the selective discounting policy for expansion projects. As the Commission has moved from a regulatory model to a model based on greater competition, it has recognized that new construction is no longer undertaken solely for the purpose of serving new markets, but also to provide natural gas customers with competitive alternatives to existing service.[40] Developing policies that encourage pipelines to actively compete with each other provides producers and end users with new market opportunities and provides customers with different supply options, which tends to reduce the delivered price of gas.

47. Eliminating the discount adjustment for new capacity could discourage pipeline expansion into areas to compete with existing service. For a pipeline to undertake an expansion into markets that are currently receiving interstate service, the new pipeline must have the flexibility to price the project to compete with the incumbent pipeline and still earn a reasonable return on that project. There would be no incentive for a pipeline to expand into an area served by another pipeline if it were required to charge a rate higher than the existing rates in the territory. Therefore, the new pipelines will need the flexibility to discount some aspect of its transportation rate.

48. Moreover, as a result of recent expansions, there are fewer captive customers,[41] and policies that encourage these expansions will provide more options to customers that are currently captive and thus enable them to benefit from the competitive markets. The Commission's policies should encourage pipelines to construct new capacity into captive markets, and the elimination of the discount adjustment for expansion capacity would not be consistent with that goal.

49. In receiving approval for the expansion project, the pipeline must meet the criteria set forth in the *Certificate Pricing Policy Statement*,[42] and if the expansion does not benefit current customers, the services must be incrementally priced. The Commission would not approve a discount adjustment in circumstances that would shift the costs of an expansion to existing customers that did not benefit from the expansion because this would be contrary to the Commission's policy.

50. Calpine states that the goal of discounting, to spread fixed costs over more customers and thereby lower costs to captive customers, is not necessarily met when discounts are provided on expansions. Calpine asserts that because discounts on expansion capacity involve the potential sharing of new fixed costs among new or existing shippers, these discounts also should bear a higher level of scrutiny before they are included in a discount adjustment.

51. As explained above, the issue of whether rates on expansion capacity are incremental or rolled-in will be determined in accordance with the *Certificate Pricing Policy Statement* and allowing an adjustment in a rate case for the discounts does not make the rates rolled-in. There is no reason to change the burden of proof with regard to discounts on expansions. As with all other discounts, the ultimate burden of proof is on the pipeline to show that the discounts were granted to meet competition.

4. Protections for Captive Customers

52. Opposition to the Commission's discount adjustment policy does not come from a wide range of interests, but from a group of publicly-owed municipal gas companies that represents a small percentage of throughput on the national pipeline system. APGA implies that all captive customers are opposed to the selective discount policy.[43] However, there are captive customers that do not oppose the Commission's selective discount policy. As the Commission explained in Order No. 637, if a customer is truly captive and has no alternatives for service it is likely that its contracts will be at the maximum rate.[44] There are many shippers that pay the maximum rate, and it is only the small publicly-owned municipal gas companies that have objected to the selective discount policy. It is possible to adopt measures to protect these customers in circumstances where the Commission's policy works an undue hardship on them and at the same time retain the competitive benefits of the policy for the majority of shippers.

53. The captive customers that oppose the Commission's selective discount policy argue that they are being harmed because it has resulted in increased rates for them. Northern Municipals gives as an example the circumstances on Northern Natural Gas Company (Northern) where Northern gave a large discount to an existing customer, Centerpoint, to prevent it from taking its business to a new intrastate pipeline. Northern Municipals states that these discounted rates will be in effect until 2019 and that Northern will attempt to

[39] They cite Certification of New Interstate Natural Gas Pipeline Facilities, 88 FERC ¶ 61,277 (1999), order on clarification, 90 FERC ¶ 61,128 (2000), order on further clarification, 92 FERC ¶ 61,094 (2000) (Certificate Pricing Policy Statement).

[40] Independence Pipeline Co., 89 FERC ¶ 61,283 at 61,843 (2000).

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

[42] 88 FERC ¶61,277 (1999), order on clarification, 90 FERC ¶ 61,128 (2000), order on further clarification, 92 FERC ¶ 61,094 (2000).

[43] APGA states that if captive customers benefited from the discounts, they would support them, but instead, captive customers are the staunchest critics of such discounts. APGA at 5–6.

[44] Order No. 637 at 217. In Order No. 637, the Commission concluded that captive customers paying the maximum rate need the protection of the right of first refusal, but that customers with alternatives that pay less than the maximum rate do not need this protection.

recover this discount from its captive shippers. Northern Municipals states that no significant additional volumes will flow as a result of the discount. Moreover, Northern Municipals states, under the present policy, Northern does not have the burden of proof to show that the discounts were either necessary or reasonable.

54. Northern Municipals does not allege that any harm has occurred to them as yet, but anticipates that the harm will occur when Northern seeks a discount adjustment in its next rate case. This harm is therefore speculative. Further, Northern Municipals' statement that Northern has no obligation to show that the discounts were necessary or reasonable is not accurate. Northern has the ultimate burden of showing that this long-term discount was in fact necessary to meet competition.[45] Further, the Commission has the obligation to assure that rates to all customers are just and reasonable and can consider mitigating measures where the rate impact on captive customers is inequitable. The circumstances described by Northern Municipals do not warrant the Commission's abandoning its selective discount policy that has provided substantial competitive benefits to a large number of shippers on the national grid.

55. There are already rate measures in place on many pipelines that give small captive customers special rates that provide them protection. For example, Northern Natural states that on its system, small shippers pay volumetric rates. Other pipelines also offer special favorable rates to small captive shippers.[46] Small shippers paying volumetric rates do not pay a reservation charge to reserve capacity and their rates are often developed using an imputed load factor that is higher than the customer's actual use of the system. Small customers therefore pay less for their service than they would if their rates were developed in the same manner as other shippers, and other shippers on the system subsidize the rates of the small shippers.

56. Further, to the extent that the Commission's discount policy furthers competition, it should encourage other pipelines to compete for the business of these captive customers. As the national pipeline grid becomes more competitive, there will be fewer captive customers, and captive customers therefore will ultimately benefit from the Commission's policies that encourage competition.

57. Moreover, the Commission has a responsibility to protect captive customers and can take action to protect these customers in case-specific situations. The Commission has always looked at the particular circumstances of each case and has adopted special protections for captive customers where circumstances warrant. For example, in *Natural Gas Pipeline Company of America*,[47] the Commission stated that it was ''mindful of our obligation to protect the pipeline's captive customers, who have little or no alternative to obtaining service over Natural's facilities,'' and rejected the pipeline's proposal to recover the costs associated with unsubscribed capacity from its captive customers. The Commission explained that it would not allow a pipeline to shift costs to its captive customers without considering the adverse effects this would have on those customers.[48] The Commission continues to be mindful of its obligation to captive customers and will consider the impact of any discount adjustment on those customers in specific proceedings.

B. Other Issues

58. As discussed above, several parties generally support the selective discount policy, but suggested certain modifications to the policy. Specifically, these parties have suggested modifications to the policy with regard to the burden of proof, requirements for periodic rate filings, and informational postings. These proposed modifications are discussed below.

1. Burden of Proof

59. Under the Commission's current policy, in order to obtain a discount adjustment in a rate case, the pipeline has the ultimate burden of showing that its discounts were required to meet competition. However, the Commission has distinguished between the burden of proof the pipeline must meet, depending upon whether a discount was given to a non-affiliate or an affiliate. In the case of discounts to non-affiliated shippers, the Commission has stated that it is a reasonable presumption that a pipeline will always seek the highest possible rate from such shippers, since it is in the pipeline's own economic interest to do so. Therefore, once the pipeline has explained generally that it gives discounts to non-affiliates to meet competition, parties opposing the discount adjustment have the burden of producing evidence that discounts to non-affiliates were not justified by competition. To the extent those parties raise reasonable questions concerning whether competition required the discounts given in particular non-affiliate transactions, then the burden shifts back to the pipeline to show that the questioned discounts were in fact required by competition.

60. APGA, Calpine, Centerpoint, Cinergy, NASUCA, Northwest Industrials, and MoPSC argue that the Commission should change this aspect of the policy and place a higher burden of proof on pipelines to justify discounts given to non-affiliates. These parties argue that the pipeline should bear a heavy burden of proof and should be required to provide sufficient and specific evidence that the discount was necessary to accomplish the transaction and that the transaction provided concrete benefits to captive customers by contributing to the recovery of fixed costs. APGA argues that the pipeline should be required to show that the discount is necessary to increase throughput in interstate commerce, not just on the discounting pipeline, and as a result, provides net benefits to captive shippers.

61. The Commission finds that its current policy regarding the burden of proof is based on accurate assumptions and produces a just and reasonable result. As explained above, the pipeline always has the ultimate burden of proof on this issue. However, in the case of non-affiliates, the Commission presumes that the pipeline will seek the highest price possible because it is in its best interest to do so. This is a reasonable presumption. A pipeline, like any other business, will act in its own best economic interest. As the Commission stated in Order No. 436, ''[u]nder economic theory, price discounting is a rational policy to pursue only when the pipeline perceives it is better to earn less than a full return on a service than to risk losing the service and failing to achieve the volumes on which its rates for the period in question were based.'' [49] It is not the case, as NASUCA suggests, that if a discount adjustment is available, the pipeline offering the discount has no incentive to minimize the level of discount. It is always in the pipeline's best economic interest to obtain the

[45] *See* the discussion on the burden of proof below.

[46] For example, El Paso and Tennessee have special rates for small customers.

[47] 73 FERC ¶ 61,050 at 61,128–29 (1995).

[48] *See also El Paso Natural Gas Co.,* 72 FERC ¶ 61,083 at 61,441 (1995).

[49] Order No. 436, *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol,* FERC Stats. & Regs., Regs. Preambles 1982–1985 ¶ 30,665 at 31,543 (1985).

highest price possible from a non-affiliate for its services.

62. Moreover, a hearing in a rate case gives all the parties an opportunity to seek discovery regarding the purpose and level of any discount. Therefore, Commission Staff and other parties can use this opportunity to seek an explanation of each discount, and if the pipeline cannot support any discount, this issue can be raised at the hearing.

63. In view of the reasonableness and accuracy of the presumption that pipelines will seek the highest rate from non-affiliated shippers, requiring the pipeline to substantiate the necessity for all unaffiliated discounts would be unduly burdensome and would discourage a pipeline from discounting. As discussed above, discounting furthers the Commission's goals of fostering a competitive natural gas market where prices reflect the market value of the capacity rather than the maximum regulated rate. It would be contrary to those goals for the Commission to adopt a policy that discourages discounting to meet competition. Similarly, where the discount results in additional throughput on the pipeline, this will necessarily provide additional revenue over which to spread the fixed costs and it is reasonable to assume that this benefits all the pipeline's customers.

64. Calpine states that short-term discounts on existing capacity may benefit shippers, but that pipelines should bear a higher burden of proof with regard to long-term discounts. The Commission finds that there is no reason to change the burden of proof with regard to long-term discount transactions.

65. In *Iroquois Gas Transmission System, L.P.,*[50] where the pipeline sought an adjustment for several long-term discounts, the Commission explained that in rebutting the presumption that non-affiliate discounts are generally given to meet competition, the parties challenging the discount adjustment need not prove conclusively that the discount was not required to meet competition, but rather must merely introduce evidence to raise a reasonable question concerning whether in fact competition required the discount. Then, the burden is shifted back to the pipeline to introduce evidence to show that competition required it to grant those discounts.

66. In *Iroquois,* the Commission disallowed the adjustment for the long-term discounts.[51] The Commission stated that while short-term and spot market data may justify a short-term discount, market conditions change over time and a long-term discount cannot be justified based solely on current market data. As the Commission explained, in the case of a long-term discount, the pipeline must present a thorough analysis of whether competition required such a long-term discount. The burden of proof is the same, but because of the nature of the transaction, the evidence required to meet that burden is different in the case of a long-term discount. The current policy therefore applies an appropriate burden of proof to both short-term and long-term discounts and the Commission finds that no change in the burden of proof is warranted.

2. Require Pipelines That Discount To File Periodic Rate Cases

67. In the NOI, the Commission stated that pipelines are no longer required to file periodic rate cases and that many pipelines have not filed a rate case for a number of years. The Commission asked the parties to address the question of how the discount policy has affected captive customers in the absence of a section 4 rate case.

68. Memphis Light, IMGA, NASUCA, NGSA, Northern Municipals, Northwest Industrials, and OAL argue that captive customers have been harmed by the absence of section 4 rate cases and that the Commission should reinstate the periodic rate filing requirement as a condition to pipelines providing discounted transportation service. These parties argue that without this requirement, pipelines can manipulate the timing of their rate filings to provide themselves with the greatest benefit. Thus, IMGA states that in the five or six years after the Commission established its discount policy, virtually all the pipelines sought and received substantial rate increases based primarily on the throughput adjustment, but also on the high interest rates and capital costs of the time. IMGA states that in recent years, interest rates and capital costs have decreased dramatically and it believes that but for the Commission's discount policy, there should have been and would have been rate proceedings producing rate reductions for most pipelines.

69. Similarly, NASUCA states that the reason many pipelines have not filed rate cases in recent years is related to the status of their earnings. NASUCA states that the Natural Gas Supply Association annually computes the status of pipeline over-earnings and their studies show that at least 13 pipelines have earned significantly more than authorized in recent years. NASUCA states that because pipelines that are over-earning their authorized returns have not filed rate cases in recent years, consumers on those systems are not seeing the benefit of increased throughput over which the pipeline's fixed costs could be spread. NASUCA states that only by analyzing all elements of cost, throughput and discounts in a section 4 rate case would the Commission be able to determine that the net result of offsetting discount adjustments and increased throughput would be zero on consumers.

70. Northwest Industrials states that because the pipelines retain all the benefits of discounted transportation between rate cases, the Commission should employ a revenue sharing mechanism to benefit customers as appropriate between rate cases.

71. NASUCA and Northern Municipals state that while customers have the right under section 5 of the NGA to file over-earnings complaints against pipelines, the lack of information posted related to discounts and pipeline throughput, the insufficiency of FERC Form 2 to provide rate case data, the shift of the burden of proof, and the prospective nature of relief under section 5 combine to make it an inadequate remedy in these circumstances.

72. On the other hand, Enbridge, INGAA, and Northwest assert that captive customers benefit from the absence of rate cases. INGAA states that for the last decade, pipeline rates have remained stable in nominal dollars and have gone down in real dollars. It asserts that timing of rate cases is now generally dictated by customer settlements or other economic or market forces. Further, INGAA states that rate cases create uncertainty, are expensive and time-consuming, and generally result in a rate increase, not a decrease. In addition, INGAA states, without the triennial review, pipelines have an incentive for cost containment and efficient operation to meet the risks associated with shorter contracts and price competition.

73. Similarly, Northwest states that that the absence of section 4 periodic rate cases has provided an additional safeguard for captive customers because the discount adjustment becomes relevant only when a pipeline seeks to adjust its rates. Northwest states that discounting encourages the pipeline to operate its system efficiently and

[50] 84 FERC ¶ 61,086 at 61,477 (1998), *reh'g denied,* 86 FERC ¶ 61,216 (1999) (Iroquois).

[51] See also, *Trunkline Gas Co.,* 90 FERC ¶ 61,017 at 61,092–95 (2002) (denying a request for an adjustment for a discounted long-term contract).

maximize its use of its system which results in the delay or elimination of the need for a rate case, resulting in long-term rate certainty for shippers.

74. At the time the discount policy was originally adopted, pipeline rates were set every three years under the terms of the Purchased Gas Adjustment (PGA) clause in their tariff. Order No. 636 eliminated the three year rate review and the PGA clause, and section 4 rate cases have been filed much less frequently by the pipelines since. However, as explained below, the Commission has determined that selective discounting does not provide a basis for reinstating a requirement that pipelines file periodic rate cases.

75. Under section 4 of the NGA, the decision to file a rate case is that of the pipeline. It has always been the option of the pipeline to file a rate case at a time when it is advantageous for it to do so. Therefore, IMGA's statement if it were not for the Commission's discount policy, there would have been rate proceedings producing rate reductions for most pipelines is not accurate. This issue is not whether pipelines can choose the timing of their rate case, but whether there is something about the discount adjustment policy that, like the PGA, justifies the requirement that pipelines file periodic rate cases. The Commission concludes that there is not.

76. Under the Commission's PGA regulations, pipelines could recover projected changes in their cost of gas using periodic purchase gas adjustments instead of filing an entire section 4 rate case. In exchange for this ability to change only one cost element pipelines agreed to a reexamination of all their costs and rates at three year intervals to assure that gas cost increases were not offset by decreases in other costs. The PGA was a special rate adjustment mechanism by which pipelines could pass through certain costs to customers between rate cases.

77. Under the selective discount policy, customer's rates are not affected until the pipeline files a rate case. There is no special rate adjustment mechanism that permits pipelines to change their rates and pass additional costs through to customers between rate cases. Therefore, we find no reason to impose a periodic rate review requirement on pipelines that engage in discounting. Selective discounting does not affect the rates of other customers on the system unless a rate case is filed. In these circumstances, the procedures provided for in sections 4 and 5 of the NGA provide sufficient protection to a pipeline's customers.

3. Informational Posting Requirements for Discount Transactions

78. NASUCA recommends that the Commission amend its regulations to require pipelines to post the reasons for each selective discount granted. NASUCA states that the Commission should provide a check-off format of reasons, including gas-on-gas competition, adverse economic conditions that could cause a customer to go out of business, existing alternative fuel capability, planned alternative fuel capability, and other reasons. The pipeline should be required to check all the relevant reasons.

79. Cinergy, on the other hand, states that the Commission's posting and reporting requirements provide the necessary transparency to the marketplace of discount transactions. However, Cinergy states that its review of the informational postings of some pipelines has revealed that much of the required information is missing. Cinergy asks the Commission to emphasize in this proceeding the importance of compliance with its posting and reporting requirements.

80. Under section 284.13(b), pipelines are required to post on their website information concerning any discounted transactions, including the name of the shipper, the maximum rate, the rate actually charged, the volumes, receipt and delivery points, the duration of the contract, and information on any affiliation between the shipper and the pipeline. Further, section 358.5(d) of the regulations requires pipelines to post on their website any offer of a discount at the conclusion of negotiations contemporaneous with the time the offer is contractually binding. This information provides shippers with the price transparency needed to make informed decisions and to monitor transactions for undue discrimination and preference. The Commission will not change its informational posting requirements at this time. However, the Commission takes Cinergy's concerns seriously and will refer allegations of non-compliance with the Commission's posting and reporting requirements to the Office of Market Oversight and Investigation for a potential audit. Furthermore, as part of the Commission's ongoing market monitoring program, the Commission will continue to conduct audits on its own.

The Commission orders:

(A) The Commission's selective discount policy is reaffirmed.

(B) This rulemaking proceeding is hereby terminated.

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

Linda Mitry,

Deputy Secretary.

WOOD, Chairman, *concurring in part*:

While I support today's decision to reaffirm the Commission's selective discounting policy, I believe that it would be more efficient, for future Commission auditing purposes, to require pipelines to specify the reason why a discount is given to a customer. In periodic audits, our staff auditors are called upon to determine whether a discount is given for legitimate business purposes. This is not only useful in designing rates in future gas pipeline rate cases, it also is necessary to comply with the Commission's regulations ensuring that pipeline transportation rate discounting not violate section 4(b) of the Natural Gas Act. Making this audit task more transparent at minimal cost is a good government step we ought to take.

Pat Wood, III,

Chairman.

KELLY, Commissioner, *dissenting in part*:

As stated in this order, the Commission's current regulations require pipelines to post certain information on their Web site related to discounted transactions, including the name of the shipper, the maximum rate, the rate actually charged, the volumes, receipt and delivery points, the duration of the contract, and any affiliation between the shipper and the pipeline. In their comments filed in this proceeding, the National Association of State Utility Consumer Advocates (NASUCA) states that what is missing from this list of information is the reason for the discount. I would have supported NASUCA's recommendation to require pipelines to post a check-off list noting the reason that they provided a discount to a particular shipper. I think that requiring such information would not be unduly burdensome on the pipelines, would help shippers to determine whether they are similarly situated and thus eligible for a similar discount, and would help the Commission to ensure that selective discounting is not unduly discriminatory under sections 4 and 5 of the Natural Gas Act. Therefore, I dissent in part from this order.

Suedeen G. Kelly.

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