ORAL ARGUMENT HAS NOT BEEN SCHEDULED

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

Nos. 04-1094, *et al.*
(consolidated)

AMERICAN GAS ASSOCIATION, *et al.*,
PETITIONERS,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
RESPONDENT.

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

BRIEF OF RESPONDENT FEDERAL ENERGY REGULATORY COMMISSION

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MARCH 29, 2005

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CIRCUIT RULE 28(a)(1) CERTIFICATE

A. Parties and Amici

The parties before this Court are identified in the brief of Petitioners.

B. Rulings Under Review

1. *Regulation of Short-Term Natural Gas Transportation Services, and Regulation of Interstate Natural Gas Transportation Services*, 101 FERC ¶ 61,127 (2002); and

2. *Regulation of Short-Term Natural Gas Transportation Services, and Regulation of Interstate Natural Gas Transportation Services*, 106 FERC ¶ 61,088 (2004).

C. Related Cases

This case has not previously been before this Court or any other court. Counsel is not aware of any other related cases pending before this or any other court.

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March 29, 2005

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GLOSSARY

AGA	*American Gas Association v. FERC*, 912 F.2d 1496 (D.C. Cir. 1990)
FERC	Federal Energy Regulatory Commission
INGAA	*Interstate Natural Gas Association of America v. FERC*, 285 F.3d 18 (D.C. Cir. 2002)
LDC	Local distribution company
MDQ	Maximum daily quantity
Mobile-Sierra	Refers to the doctrine of *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp*., 350 U.S. 332 (1956) and *FPC v. Sierra Pacific Power Co*., 350 U.S. 348 (1956)
NGA	Natural Gas Act
NOPR	*Regulation of Short-Term Natural Gas Transportation Services, Notice of Proposed Rulemaking*, 63 Fed. Reg. 42982, FERC Stats. & Regs., 1988-1998 ¶ 32,533 (1998)
NPV	Net Present Value
Order No. 636	*Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation; and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, Order No. 636, FERC Stats. & Regs. **&**30,939, *order on reh'g*, Order No. 636-A, FERC Stats. & Regs. **&**30,950, *order on reh'g*, Order No. 636-B, 61 FERC **&**61,272 (1992), *reh'g denied*, 62 FERC **&**61,007 (1993)
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Process Gas	*Process Gas Consumers Group v. FERC*, 292 F.3d 831 (D.C. Cir. 2002)
Rehearing Order	*Regulation of Short-Term Natural Gas Transportation Services, and Regulation of Interstate Natural Gas Transportation Services*, 106 FERC ¶ 61,088 (2004)
Remand Order	*Regulation of Short-Term Natural Gas Transportation Services, and Regulation of Interstate Natural Gas Transportation Services*, 101 FERC ¶ 61,127 (2002)
ROFR	Right of first refusal
Tennessee Orders	*Tennessee Gas Pipeline Co*., 91 FERC &61,053 (2000), *reh'g*, 94 FERC &61,097 (2001)
UDC	*United Distrib. Cos. v. FERC*, 88 F.3d 1105 (D.C. Cir. 1996)

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

BRIEF OF RESPONDENT
FEDERAL ENERGY REGULATORY COMMISSION

STATEMENT OF THE ISSUES

1. Whether the Commission reasonably concluded that no term-matching cap was necessary for the right of first refusal because existing regulatory controls prevent the exercise of pipeline market power, and a term cap would distort the market and preclude the efficient allocation of capacity to the shipper valuing it the most.

2. Whether the Commission reasonably concluded that the failure to permit forwardhaul and backhaul transactions where operationally feasible restricts the efficient use of capacity without adequate justification and is therefore unjust and unreasonable where forwardhaul and backhaul transactions aid in creating additional supply alternatives for shippers and enhance competition on the pipeline's system, and this policy can be implemented through pipeline tariffs without modification to shipper contracts with the pipeline.

STATUTORY AND REGULATORY PROVISIONS

The pertinent statutes and regulations are contained in the Addendum to this brief.

STATEMENT OF THE CASE

I. Nature of the Case, Course of Proceedings, and Disposition Below

The Right of First Refusal

FERC Order No. 436[1] provided pipelines with pre-granted abandonment authority under NGA § 7(b), 15 U.S.C. § 717f(b), to terminate transportation contracts when they expire.[2] Order Nos. 636 and 636-A[3] tempered that grant with protection for captive customers from the exercise of pipeline monopoly power when transportation contracts expire, by providing existing shippers with the right of first refusal ("ROFR"). The ROFR gave existing shippers the right to retain their transportation capacity by matching the highest rate and the longest term offered by other bidders, with bids capped at the pipeline's maximum transportation rate and a contract term of 20 years. This Court approved the ROFR mechanism, but remanded the 20-year term matching cap for further explanation, finding that the Commission had not adequately explained how a 20-year cap would protect against a pipeline's exercise of market power by requiring shippers to bid up contract length.[4]

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[1] *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, Order No. 436, 50 Fed. Reg. 42,408 (1985), FERC Stats. & Regs., Regs. Preambles, 1982-1985 ¶ 30,665 (1985), *vacated and remanded*, *Associated Gas Distribs. v. FERC*, 824 F.2d 981 (D.C. Cir. 1987), *readopted on an interim basis*, Order No. 500, 52 Fed. Reg. 30,334 (1987), FERC Stats. & Regs., Regs. Preambles, 1986-1990 ¶ 30,761 (1987), *remanded, American Gas Association v. FERC*, 888 F.2d 136 (D.C. Cir. 1989), *readopted* Order No. 500-H, 54 Fed. Reg.

Order No. 636-C[5] reduced the term matching cap to five years, which was retained in Order No. 637.[6] On review of Order No. 637, *INGAA*, 285 F.3d at 53, found the Commission had neither adequately explained the selection of the five-year cap nor answered significant concerns regarding the effect of the cap on

52,344 (1989), FERC Stats. & Regs., Regs. Preambles, 1986-1990 ¶ 30,867 (1989), *on reh'g*, Order No. 500-I, 55 Fed. Reg. 6605 (1990), FERC Stats. & Regs., Regs. Preambles, 1986-1990 ¶ 30,880 (1990), *aff'd in part and remanded in part*, *American Gas Association v. FERC*, 912 F.2d 1496 (D.C. Cir. 1990)("*AGD*").

[2] *American Gas Association v. FERC*, 912 F.2d 1496, 1513-14 (D.C. Cir. 1990) ("*AGA*").

[3] *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation; and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, Order No. 636, FERC Stats. & Regs. &30,939, *order on reh'g*, Order No. 636-A, FERC Stats. & Regs. &30,950, *order on reh'g*, Order No. 636-B, 61 FERC &61,272 (1992), *reh'g denied*, 62 FERC &61,007 (1993).

[4] *United Distrib. Cos. v. FERC*, 88 F.3d 1105, 1140-41 (D.C. Cir. 1996) ("*UDC*").

[5] *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation Under Part 284 of the Commission's Regulations, and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, Order No. 636-C, 78 FERC &61,186 (1997).

[6] *Regulation of Short-Term Natural Gas Transportation Services and Regulation of Interstate Natural Gas Transportation Services,* Order No. 637, FERC Stats. & Regs. Regulations Preambles (July 1996-December 2000) &31,091, *on reh'g,* Order No. 637-A, FERC Stats. & Regs, Regulations Preambles (July 1996-December 2000) &31,099, *on reh'g,* Order No. 637-B, 92 FERC &61,062 (2000)*; aff'd in part and remanded in part, Interstate Natural Gas Association of America v. FERC,* 285 F.3d 18 (D.C. Cir. 2002) *("INGAA").*

efficient capacity allocation and the relative risk allocation between pipelines and existing shippers.

In the challenged orders on remand from *INGAA*, *Regulation of Short-Term Natural Gas Transportation Services, and Regulation of Interstate Natural Gas Transportation Services*, 101 FERC ¶ 61,127 (2002) ("Remand Order"), *on reh'g*, 106 FERC ¶ 61,088 (2004) ("Rehearing Order"), the Commission determined that a term-matching cap is not necessary to protect a pipeline's existing long-term firm customers from the pipeline's exercise of market power given other regulatory controls in place. In making that determination, the Commission followed the reasoning of *Tennessee Gas Pipeline Co.*, 91 FERC &61,053 (2000), *reh'g*, 94 FERC & 61,097 (2001) ("*Tennessee* Orders"), *aff'd, Process Gas Consumers Group v. FERC*, 292 F.3d 831 (D.C. Cir. 2002) ("*Process Gas*"). Eliminating the cap also answered the concerns expressed in *INGAA* regarding the potential adverse effects of a term cap on efficient capacity allocation and allocation of risk.

Forwardhauls and Backhauls to Same Delivery Point

Order No. 637 allowed shippers to divide their mainline capacity into segments, and to overlap transportation on those mainline segments, so long as the shipper did not exceed the contract demand of the underlying contract. Order No. 637-A clarified that a shipper would not be overlapping segments by using a

forwardhaul and backhaul[7] to bring gas to the same delivery point. Order No. 637-A at 31,592-93. It was argued that this clarification permits shippers to exceed their contracted-for capacity at the delivery point. *Id. INGAA* remanded this issue for further explanation, finding that the Commission had not adequately addressed whether this policy modified the contracts between a pipeline and its shippers or adequately supported the need for contract modification. *INGAA*, 285 F.3d at 41. In the challenged orders, the Commission affirmed its policy that a segmented transaction consisting of a backhaul up to contract demand and a forwardhaul up to contract demand is permitted, as it does not increase shippers' rights to contracted-for primary point capacity,[8] and the failure to allow segmenting and flexible point rights to the extent operationally feasible, including forwardhauls and backhauls to the same point, was unjust and unreasonable.

This appeal followed.

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[7] "Backhaul" refers to the "process of accepting gas at one point in a pipeline's flow and delivering an equivalent amount of gas at a destination point that is actually 'upstream' from the point of entry.'" *Associated Gas Distribs. v. FERC*, 899 F.2d 1250, 1254 n. 1 (D.C. Cir. 1990). For example, on a pipeline that flows from Points A to B to C and beyond, the injection of gas at Point C for delivery to Point B would entail a backhaul.

[8] In that situation, the backhaul gas, even though delivered to the same point, is received at that point on a secondary point basis, and is subject to inferior scheduling rights.

II. Statement of Facts

A. The ROFR Term-Cap

1. Background

NGA § 7(b) prohibits pipelines from abandoning certificated firm-transportation service prior to a finding that the "present or future public convenience or necessity permit such abandonment." In Order No. 436, the Commission provided for automatic "pre-granted abandonment" for all firm transportation service provided under a Part 284 blanket certificate. 18 C.F.R. § 284.221(d). In the absence of pre-granted abandonment, a pipeline would be required to continue service indefinitely, despite expiration of the contract, until it received individual abandonment approval under NGA § 7(b). *AGA*, 912 F.2d at 1514. *AGA* remanded pre-granted abandonment for further explanation, finding that "the Commission has not yet adequately explained how pregranted abandonment trumps another basic precept of natural gas regulation – protection of gas customers from pipeline exercise of monopoly power through refusal of service at the end of a contract period." *Id.*

Order No. 636 reconciled those two policies by allowing an existing customer of long-term firm transportation service to exercise ROFR rights if it matched the rate and term of competing bidders for its capacity. *UDC*, 88 F.3d at 1137-38 (citing 18 C.F.R. § 284.221(d)). Order No. 636-A capped the contract

term for capacity at 20 years and the price at the pipeline's maximum firm transportation rate. *Id*. at 1139.

On appeal, *UDC* found that the ROFR provided substantial protection to existing customers. *Id.* As shippers will bid against one another for capacity, the pipeline will be prevented from using the ROFR to push the rate above the competitive market price. *Id*. Further, the ROFR price cap of the maximum just and reasonable firm transportation rate protects shippers from rates above the Commission-approved level. *Id*. Thus, "[i]f the existing customer is willing to pay the maximum approved rate, then the right-of-first-refusal mechanism ensures that the pipeline may not abandon the certificated service." *Id*. at 1140. The Court found that this basic structure provided the protections from market power required to allow pre-granted abandonment under NGA § 7. *Id*.

UDC remanded, however, the choice of a 20 year contract term for further explanation of how it would protect captive customers from an exercise of market power that required longer contract terms. *Id*. The Court also questioned the evidentiary support for a twenty-year cap, as most commenters proposed much shorter contract caps, such as five years, and the evidence showed that 20-year contracts, while typical for construction of new facilities, were not typical for the continuation of service after contract expiration. *Id*. at 1141.

On remand, in Order No. 636-C, and in Order No. 637, the Commission reduced the 20-year cap to five years, based on a current industry trend toward shorter contract terms. *INGAA*, 285 F.3d at 52. On appeal, *INGAA* found that the five year cap was chosen with "little indication of why [FERC] thought that this new figure would appropriately balance the protection of captive customers with the furtherance of market values (putting capacity in the hands of those who value it most)." *Id*. *INGAA* also found that the Commission failed to address its own concerns regarding the effect of the matching cap, as a disincentive for existing shippers to enter into contracts longer than five years duration with a resulting bias toward shorter term contracts. *Id*. at 52-53. The Court was also concerned that the cap would create a risk imbalance between pipelines and existing shippers, permitting shippers indefinite control over pipeline capacity but providing the pipeline no corresponding protections. *Id*. at 53.

2. The *Process Gas* Decision

Shortly after *INGAA*, this Court decided *Process Gas*, 292 F.3d 831, which affirmed the Commission's elimination of a term-matching cap in the context of capacity allocations to new customers on a pipeline. Prior to that decision, the pipeline in *Process Gas* originally allocated scarce firm capacity on a first-come, first-served basis, and then replaced that with a net present value ("NPV") method, under which the pipeline accepted the bid with the highest NPV. *Id*. at 833. The

new system had the advantage of awarding capacity to those shippers who valued it most. *Id.* However, certain shippers raised concerns that, as FERC sets the maximum rate, the pipeline may exercise its market power to induce shippers to bid for longer contracts than they would in a competitive market, as a surrogate for price. *Id*. In response to these concerns, the Commission approved the pipeline's proposal to institute a twenty-year term cap. *Id*. at 834.

That switch was addressed in *Process Gas Consumers Group v. FERC*, 177 F.3d 995, 997 (D.C. Cir. 1999), which remanded the term cap issue for an explanation why, since competitive contracts generally run no more than fifteen years, the twenty year cap would "prevent the NPV method from compelling shippers to offer the pipeline longer contracts than they would in a competitive market." *Id*. at 1003.

On remand, the Commission removed the term cap altogether, on the basis that other regulatory checks minimized risk that a pipeline could exercise market power to force shippers into excessively long contracts. *Process Gas*, 292 F.3d at 834. Specifically, the Commission relied upon its regulations setting maximum pipeline transportation rates, and requiring pipelines to sell all available capacity to shippers willing to pay that maximum rate.

> There is little reason for the pipeline to exercise market power by withholding new capacity because the maximum rates established by the Commission prevent [the pipeline] from charging rates above the just and reasonable rates based on its cost of service. As a result, even

> if the pipeline refused to build new capacity, its annual revenues in any given year would be capped at its annual cost of service. All that the pipeline could potentially accomplish by withholding new capacity is getting the customers to sign up for longer term contracts than they otherwise might …. But this gives the pipeline no immediate benefit in the form of increased revenues or profits. It just reduces its long-term risk somewhat by enabling it to obtain contracts with longer terms. By contrast, if the pipeline built new capacity to serve the increased demand, it could increase its current revenues and profits … As a result, even without a term matching cap, it would appear that a pipeline has a greater incentive to build new capacity to serve all the demand for its service, rather than withhold capacity (by refusing to build new capacity) in order to create scarcity.

Id. at 836-37 (quoting *Tennessee Gas Pipeline Co*., 91 FERC at 61,191). If a pipeline ever refused to build new capacity to meet shipper demands, the shippers could file a complaint. *Id*. at 837.

Further, because there was not a widespread market for primary pipeline capacity, there is no way of estimating what term length such a competitive market would produce. *Id*. Any cap would therefore be arbitrary and its enforcement could distort efficient operation of a market by preventing a shipper willing to offer a longer contract term from doing so. *Id*.

Process Gas agreed that, because FERC already requires pipelines to sell all available capacity at the FERC-regulated maximum rates, pipelines have neither "the legal ability to withhold existing capacity nor an incentive to refuse to build new capacity." *Id*. at 837. In addition, any attempt by the pipeline to manipulate the bidding process would be actionable as a violation of other Commission rules.

Id. "Accordingly, as FERC argues, the fact that shippers may at times bid up contract length likely reflects not an exercise of Tennessee's market power, but rather competition for scarce capacity." *Id.* The Court further observed that, even if it were skeptical of FERC's conclusion regarding existing regulatory controls, "that conclusion embodies precisely the sort of prediction about the behavior of a regulated entity to which – in the absence of contrary evidence – we ordinarily defer." *Id.* at 838.

Process Gas involved the bidding process for new shippers which the petitioners therein attempted to liken to the ROFR bidding process. *Id.* The Court was not persuaded, finding the ROFR situation in flux with the ROFR term-cap issue once again on remand, and, in any event, new shippers do not enjoy comparable NGA § 7 protection from the abandonment of service as do ROFR shippers. *Id.*

3. The Challenged Orders

On remand from *INGAA*, the Commission removed the ROFR term matching cap in reliance on the reasoning affirmed in *Process Gas*. Remand Order ¶¶ 11-15, JA 3-4.

In response to the Court's requirement that the Commission find "'that existing market conditions and regulatory structures protect customers from pipeline market power,'" *id.* ¶ 10, JA 3 (quoting *UDC*, 88 F.3d at 1139), the

Commission determined that existing regulatory controls are sufficient to constrain pipelines from withholding capacity (to create artificial scarcity) to pressure shippers into longer contracts than they desire, without the need for any term-matching cap. *Id.*; Rehearing Order ¶ 17, JA 17.

Because pipelines must sell all available capacity to shippers willing to pay the maximum FERC-approved rate, pipelines can only create scarcity by refusing to build additional capacity when demand requires it. Remand Order ¶ 12, JA 3. Where demand is greater than existing capacity, however, pipelines have a greater incentive to build than to withhold capacity, as they can increase current revenues and profits by investing in additional facilities to serve the increased demand. *Id.* In addition, if a pipeline refused to build new capacity, shippers could file a complaint. *Id.* The Commission's regulations prohibit pipelines from favoring their affiliates or colluding with them to manipulate the market through sham bids. *Id.* That reasoning followed the teaching of *Process Gas*. *Id.* ¶ 13, JA 3-4 (quoting *Process Gas*, 292 F.3d at 837).

Reliance on the *Tennessee Orders* and *Process Gas* was proper. Rehearing Order ¶ 21, JA 18. *Process Gas* did not prohibit consideration of how regulatory controls affect the need for a ROFR term cap; rather, the ROFR situation simply requires additional consideration of whether, under NGA § 7(b), pre-granted abandonment is in public convenience and necessity, a finding made in the instant

case. *Id*. The ROFR assures that, if an existing customer is willing to pay the maximum rate and match a rival bidder's contract term, the pipeline may not abandon service to that customer. Remand Order ¶ 14, JA 4 (citing *UDC*, 88 F.3d at 1140-41); Rehearing Order ¶ 22, JA 18. Thus, even a captive customer served by a single pipeline can retain its long-term service against rival bidders, and is therefore provided the protection from pipeline market power required for pregranted abandonment. *Id*. As "other regulatory constraints adequately limit [the pipeline's] ability, as well as any incentive, to induce lengthy contracts," no term cap is required to protect existing captive customers with ROFRs from pipeline market power. Remand Order ¶ 15, JA 4 (quoting *Process Gas*, 292 F.3d at 837).

Removing the term-matching cap addressed the *INGAA* concerns that a term matching cap: (1) allows customers to hold pipelines to a perpetual service commitment with no corresponding protection for the pipeline from ultimately being left with stranded capacity; and (2) does not result in the efficient allocation of capacity, *i.e*., putting capacity in the hands of those who value it most. Remand Order ¶¶ 16, 17, JA 4; Rehearing Order ¶ 43, JA 22. Removing the term matching cap also eliminates the concern that a five-year cap would result in a bias toward shorter-term contracts. Remand Order ¶ 17, JA 4; Rehearing Order ¶ 17, JA 17. Finally, removing the cap avoided the difficult chore of trying to estimate a

competitive contract term in the absence of any widespread competitive market for primary pipeline capacity. Remand Order ¶ 18, JA 4; Rehearing Order ¶¶ 17, 43, JA 17, 22. The data available for setting a cap related to existing service on regulated pipelines, which provides no basis to estimate what contract terms would be in a truly competitive market. *Id.* Establishing any cap absent evidence of contract terms in a competitive market may prevent the customer who valued the capacity the most from getting it, since the customer could not bid a longer term than set by such a cap. *Id.*

Thus, a ROFR with no term cap strikes the best balance among existing customers, new customers, and the pipelines. Rehearing Order ¶ 18, JA 17. To the extent pipelines nonetheless attempt to exercise market power, the complaint process will provide adequate protection. *Id.* Since the matching cap was eliminated in October 2002, no shipper has filed such a complaint, and the Commission has found no allegations in other complaints that the ROFR bidding process has been abused. *Id.* In addition, the Commission reviews pipeline tariffs, and monitors bidding procedures and evaluation methods to ensure that the ROFR process is fair, and will continue to monitor the ROFR process and evaluate whether additional controls are necessary. *Id.* ¶¶ 19, 23, JA 18, 19. Although the Commission may not have authority upon complaint to compel construction of new capacity, it can in any event impose other remedies (such as reimposing a term

cap) if it finds that a pipeline is attempting to exercise market power. Rehearing Order ¶ 30, JA 20.

Non-pipeline parties argued that removing the five-year cap could cause captive customers to have to match extremely long-term bids. Remand Order ¶ 19, JA 4. At the same time, these parties argued that the five-year term matching cap would not lead to shorter contract terms than would otherwise occur, since non-captive customers under the five-year cap generally were able to negotiate contract terms of less than five years. *Id.*[9] The latter information seemingly undercuts the former claims. *Id.* ¶ 20, JA 5. Even if bids longer than five years are made, requiring the existing shipper to match such bids will help assure that capacity goes to the shipper that values it the most. *Id.*

Other safeguards protect against pipelines' exercising market power through extra-tariff special advantages or conditions that customers forgo challenges to prudence. The Order No. 636 ROFR rules forbid pipelines seeking special

[9] For example, petitioner American Gas Association ("AGA"), relying on data for contracts with effective dates after January 1, 1999, indicated that 49 percent of the contracts are for less than three years and only 6.4 percent had terms of exactly five years, so that the five-year cap does not distort the market. *Id.* Mississippi Valley Gas Company asserts the five-year cap has not caused a significant reduction in the length of long-term contracting. *Id.* and n. 18 (citing *Regulation of Short-Term Natural Gas Transportation Services, and Regulation of Interstate Natural Gas Transportation Services*, 99 FERC ¶ 61,245 (2002) (Table 1). The American Public Gas Association notes Table 1 shows that almost 60 percent of the contracts with terms of five years or less had terms of one to two years, while only about 15 percent had terms of five years, so that the five-year cap is not driving the market. *Id.*

advantages from shippers seeking to retain capacity. Rehearing Order ¶ 29, JA 20. A shipper need only sign a *pro forma* service agreement at the maximum tariff rate, which contains no special terms and conditions, to retain capacity. *Id*. Order No. 637 precludes pipelines from negotiating terms and conditions of service with shippers different from those set forth in their tariff. *Id*. (citing Order No. 637 at 31,343). Pipelines must file any service agreements that contain material deviations from their *pro forma* tariff, which permits review to eliminate any unlawful provisions. *Id*.

As new capacity generally takes years to construct, construction of new capacity will not provide immediate replacement capacity to shippers that choose not to match the highest bid and exercise their ROFR. Rehearing Order ¶ 26, JA 19. However, the pipelines' lack of incentive to withhold capacity under the existing regulatory controls prevents the exercise of market power, so that, if longer terms are required to retain existing capacity, they are justified by the scarcity of current capacity. *Id*. Any cap would therefore artificially distort bidding, and not permit the allocation of current capacity to the customer valuing it most. *Id*.

The local distribution companies ("LDCs") asserted that their public service obligation requires, in the 20 states where they are the retail supplier of last resort, that they match the longest term bid for the expiring contracts, no matter what their

needs. Rehearing Order ¶ 32, JA 20. If states with retail choice later eliminate the LDC's buyer of last resort obligation, LDCs asserted any long-term contracts that they have been forced to enter into will impose stranded costs on their retail customers. *Id.*

The Commission did not find that possibility to outweigh the benefit of allocating scarce capacity to the party valuing it the most. Nor did the LDCs explain why existing shippers should be able to retain capacity that another shipper values more highly. *Id.* ¶ 33, JA 20. Further, LDCs can market through FERC's capacity release program any capacity they retain but cannot use, thereby obtaining reimbursement of their reservation charges. *Id.* ¶¶ 18, 34, JA 17, 21. Under Commission policy, the LDC, by permanently releasing such capacity to a qualified and creditworthy shipper, could extinguish its contractual obligation to the pipeline. *Id.*

Additionally, it is speculative whether LDCs will be released from their supplier of last resort obligation, and, if they are, it is not certain affected LDCs will have unused capacity from contracts for more than five years that will lead to stranded costs. *Id.* ¶ 35, JA 21. The Industrials' study concluded that the five-year cap, while it was in effect from 1997 through 2002, had little or no impact on contracting practices, and that very few contracts with terms of five years or more were signed each year. *Id.* If five-year bids were uncommon when a five-year cap

was effective, there appears little reason to think bids will increase once the cap is removed. *Id*. Finally, LDCs with excess capacity may take advantage of capacity release to reduce their costs. *Id*.

AGA asserted costs will increase because LDCs will be unable to decrease their capacity within a reasonable time if substantial numbers of their retail customers switch to other suppliers. *Id*. ¶ 36, JA 21. This assertion relied on anecdotal evidence of one unnamed LDC that allegedly experienced such a large switch in retail customers, which the Commission found to be insufficient evidence on which to base a finding of potential widespread harm to LDCs. *Id*.

The Commission considered evidence purporting to show that the five-year cap falls within a three to ten year zone of reasonableness, but that did not show continuing a term matching cap was necessary or appropriate. *Id*. ¶ 42, JA 22. Further, even assuming this zone of reasonableness to be accurate, there is no reason to assure existing shippers that their contracts terms will always be at the lower end of this zone, regardless of the willingness of other shippers to bid longer terms. *Id*. In any event, the median and average contract terms studied were less than five years, and thus supported the Commission's finding that current regulatory controls adequately constrain potential pipeline exercise of market power, so that shippers are not forced to bid longer contract terms than a competitive market would require. *Id*. Regardless of whether five years might be

a reasonable cap, the Commission is not obliged to adopt it where other reasonable policies, such as the removal of the cap, serve the NGA's objectives. *Id.*

B. Forwardhauls and Backhauls to Same Delivery Point

1. Background

Prior to Order No. 636, pipeline tariffs and contracts only allowed a shipper to use the primary receipt and delivery points listed in its contract, and did not permit capacity release or segmentation. Remand Order ¶ 49, JA 10. In Order No. 636, the Commission determined that shippers' firm transportation capacity should have comparable flexibility to what a pipeline enjoyed when it provided bundled sales service. *Id.* As pipelines had flexible point rights and segmentation for their own capacity, Order No. 636 required pipelines to modify their tariffs to provide capacity release, flexible point rights, and segmentation to their shippers. *Id.* (citing Order No. 636 at 30, 420-21 and 30, 428-29; Order No. 636-A, at 30, 582-85). Flexible receipt and delivery points promote maximum efficient use of the pipeline system, and are necessary to the development of market centers and to achieve a meaningful capacity release program. *Id.* (quoting Order No. 636-A at 30, 582). Order No. 636-B clarified that the policy that firm shippers should be able to make full use of their pipeline capacity through release transactions applies as well to backhaul arrangements. *Id.* (citing Order No. 636-B, 61 FERC ¶ 61,272 at 61,997 (1992)).

Order No. 637 allowed shippers to divide their mainline capacity into segments, to ship an amount equal to the contract demand of the original contract on each segment, and to overlap those segments, so long as any shipment on any segment did not exceed the contract demand of the underlying contract. Remand Order ¶ 38, JA 8. Order No. 637-A clarified that a shipper may use a forwardhaul and backhaul (reversal of flow) to bring gas to the same delivery point so long as the amount on any segment does not exceed the shippers' contract demand. *Id.* This determination was challenged on appeal on the ground that it permits shippers to exceed their contracted-for capacity at the delivery point. *Id.* *INGAA* remanded this issue, finding that the Commission had not adequately explained whether this policy modified the contracts between a pipeline and its shippers, or adequately supported the need for any contract modification. *INGAA*, 285 F.3d at 41.

2. The Challenged Orders

On remand the Commission affirmed that a segmented transaction consisting of a backhaul up to contract demand on one segment and a forwardhaul up to contract demand on another segment with both going to the same point is permitted. Remand Order ¶ 39, JA 8. The necessary findings to justify an NGA § 5, 15 U.S.C. § 717d, tariff change rest on the conclusion that failure to allow segmented transactions where operationally feasible unjustifiably restricts efficient use of the system. Remand Order ¶ 54, JA 11. In addition, Order Nos. 636 and

637 granted shippers secondary rights to use all points in zones for which they are paying. Rehearing Order ¶ 74, JA 27. Order No. 636 also found that not providing shippers with the same flexibility as pipelines enjoyed was unduly discriminatory and unreasonable. Remand Order ¶ 55, JA 12; Rehearing Order ¶ 74, JA 27 (citing Order No. 636-A at 30,582). All those factors lead to the conclusion that failure to permit segmentation is unjust and unreasonable because it restricts efficient use of capacity without adequate justification. Remand Order ¶ 54, JA 11; Rehearing Order ¶ 74, JA 27.

These findings are applicable to and support the forwardhaul/backhaul policy, as it carries out the policies of segmentation and flexible point rights by creating additional supply alternatives for shippers, thus enhancing competition on the pipeline's system. Rehearing Order ¶ 75, JA 27. The Commission implemented flexible point rights, capacity release and segmentation, in part, to create more competition in the transportation market, including competition between capacity release and the pipeline's sale of interruptible and short-term firm service. Remand Order ¶ 55, JA 12. Giving shippers the ability to schedule forwardhauls and backhauls to the same point is consistent with that goal. *Id.*

The Commission implemented the forwardhaul/backhaul policy by requiring pipelines to file tariff sheets revising their tariff terms and conditions of service to expressly permit these transactions. Remand Order ¶ 58, JA 12. Implementation

of this policy did not require modification of individual shipper contracts. *Id.* ¶ 44, JA 9. As required by 18 C.F.R. § 154.110, pipeline tariffs must include *pro forma* service agreements, which set forth the standard contract the pipelines will enter into with all shippers. *Id.* ¶ 45, JA 9. The *pro forma* service agreements incorporate the terms and conditions of the pipeline tariff, as those may change from time to time, and allow pipelines to change their rates, rate schedules, and terms and conditions of service by making NGA § 4, 15 U.S.C. § 717c, filings. *Id.* Commission policy prohibits pipelines from negotiating different terms and conditions of service with particular customers from those set forth in their generally applicable tariffs and *pro forma* service agreements. *Id.* (citing Order No. 637 at 31,342-44; Order No. 637-A at 31,647-48). As pipelines' standard service agreements automatically give shippers any increased rights which may be provided by changes in the terms and conditions of service in a pipeline's tariff, the forwardhaul/backhaul policy was implemented fully by revisions to pipeline tariffs, and the Commission need not modify any term in the individual service agreements to implement the forwardhaul/backhaul policy. Remand Order ¶¶ 46, 47, JA 10.

Shipper service agreements specify the maximum contract demand to be delivered at specified primary delivery points, defining shippers' guaranteed right to deliveries. *Id.* ¶ 48, JA 10; Rehearing Order ¶ 57, JA 25. Backhauls are

scheduled on a secondary basis, which means that they are only delivered to a particular point if capacity remains available after primary guaranteed service at that point is provided. Rehearing Order ¶ 58, JA 25. Because backhauls do not increase a pipeline's obligation to provide primary firm deliveries, they do not modify the terms of the primary firm guaranteed service at the primary delivery points specified in the shipper contracts. *Id.* ¶¶ 57, 58, JA 25.

While the total of the primary forwardhaul and secondary backhaul deliveries at a point may exceed the shipper's contract demand, this is not significantly different from two forwardhaul segmented transactions, whose deliveries combined would also exceed the shipper's contract demand. Rehearing Order ¶ 59, JA 25. For example, if a shipper has a contract demand of 100 Dt from points A to C, with primary delivery point rights of 100 Dt at point C, it could divide its capacity into geographic segments, A to intervening secondary point B, and B to C. *Id.* The shipper could segment (A to B) and (B to C), ship 100 Dt on each segment, for combined total deliveries of 200 Dt, without exceeding the mainline contract demand limit of 100 Dt. *Id.*

The key point is that, in any segmented transaction, deliveries in excess of contract demand always occur on a secondary basis, so the pipeline never provides greater primary firm service than required in its contract. *Id.* ¶ 60, JA 25. Under the Commission's segmentation policy, a shipper can use its mainline capacity

flexibly so long as it does not exceed the mainline contract capacity on any segment, regardless of how much gas it takes off the system in total. *Id.* ¶ 57, JA 25. As with a segmented transaction consisting of two forwardhauls, a segmented transaction consisting of a backhaul and a forwardhaul to the same point does not exceed the shipper's mainline capacity at any point, because in both cases, no gas flows anywhere on the mainline in excess of the shipper's contract demand. *Id.*

The forwardhaul/backhaul policy does not give shippers more than the capacity for which they have paid. Remand Order ¶ 56, JA 12; Rehearing Order ¶ 68, JA 27. As shippers must pay the entire zone cost on a pipeline regardless of the actual length of their haul within that zone, Commission policy allows a shipper to use, on a secondary basis, all of the points within a zone for which it is paying. *Id.* That policy specifically applies to backhauls as well as other segmented transactions. *Id.* The policy works no harm on the pipelines as they have fully allocated their costs and are collecting those costs from their shippers. *Id.* If segmented transactions cause a decrease in a pipeline's sale of interruptible or short-term firm transportation, then the pipeline may file a new rate case in which more of its costs would be allocated to firm service. *Id.* [10]

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[10] Revenues from interruptible or short-term firm transportation are credited to a pipeline's cost of service and the remainder is then allocated among the pipeline's firm shippers. As the credit is estimated, should interruptible and short-term firm sales decline, a pipeline's actual revenues may be less than the estimated

Nor does the forwardhaul/backhaul policy create new certificated service levels in violation of NGA § 7(a). Rehearing Order ¶ 88, JA 30. The Commission did not see this as creating a new service, but, as it did in Order No. 636, mandating changes to the entire structure of the gas industry, which had been found to be unjust and unreasonable. *Id.* ¶ 89, JA 30 (citing Order No. 636 at 30,422-23; Order No. 636-A at 30,530-33). Section 7(a) applies only to new service; it does not prevent the Commission from requiring changes in unlawful terms of existing service. *Id.*

The Commission determines the need for changes to pipeline tariffs under the just and reasonable standard of NGA §§ 4(e) and 5(a), not under the more stringent *Mobile-Sierra*[11] public interest standard. Remand Order ¶ 46, JA 10 (citing *INGAA*, 285 F.3d at 38). Because the tariff change required here does not modify the primary guaranteed firm service specified in the shipper contracts, Rehearing Order ¶¶ 57, 58, JA 25; Remand Order ¶ 48, JA 10, and the shipper contracts automatically incorporate changes in pipeline tariff terms and conditions,

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credit. If the different between estimated and actual is large enough, a pipeline could file a rate case to reduce the credit, thereby allocating a greater share of its cost of service to firm shippers.

[11] *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956) ("*Mobile*"); *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956) ("*Sierra*") (collectively "*Mobile-Sierra*"). Under the *Mobile-Sierra* doctrine, where parties have negotiated a contract that sets fixed prices and denies either party the right to change such prices unilaterally, FERC may abrogate or modify the contract only if the public interest so requires.

there has been no modification of shipper contracts that could trigger *Mobile-Sierra* protections. Rehearing Order ¶ 85, JA 29; Remand Order ¶ 47, JA 10.

Further, under the Supreme Court's *Memphis*[12] decision, parties can negate *Mobile-Sierra* protections by expressly providing that the pipeline can make unilateral changes during the contract terms subject to FERC review under the just and reasonable standard. Rehearing Order ¶ 84, JA 29 (citing *Boston Edison Co. v. FERC*, 233 F.3d 60, 66 (1st Cir. 2000)). Here, the shipper contracts permit such changes. Rehearing Order ¶ 83, JA 29.

Increasing firm shippers' rights to use points on a secondary basis through modifying pipeline tariffs under NGA § 5, without modifying shippers' individual service agreements, follows the approach taken in Order No 636 in implementing the Commission policies on segmentation and flexible receipt and delivery points, which was not challenged in the appeal of Order No. 636. Remand Order ¶¶ 49, 50, JA 10, 11.

Order No. 637 again found that segmentation increases the number of capacity alternatives and so improves competition and facilitates the development of market centers. *Id.* ¶ 51, JA 11. Because pipelines did not appear to be in compliance with the Order No. 636 segmentation policy, Order No. 637 included the right to segment capacity in the Commission's regulations, and made a generic

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[12] *United Gas Pipe Line Co. v. Memphis Light, Gas & Water Div.*, 358 U.S. 103, 112 (1958).

finding that pipelines not permitting segmentation where operationally feasible are acting in an unjust and unreasonable manner. *Id.* Segmentation must include flexible point rights for shippers to create effective competition between pipeline services and released capacity and also to permit a shipper to make the most effective use of its own capacity. *Id.* *INGAA* affirmed both segmentation and flexible point rights requirements as continuations of the policies adopted in Order No. 636. *Id.* (citing *INGAA*, 285 F.3d at 39-40). Again, the Order No. 637 segmentation and flexible point rights requirements were implemented by requiring the pipeline to modify the terms and conditions of service in its tariff under NGA § 5. *Id.*

Further, the Commission's policies concerning flexible point rights and segmentation generally permit shippers to make total deliveries in excess of their mainline contract demand. *Id.* ¶ 52, JA 11. Since shippers' individual contracts with the pipelines provide for the shipper to receive the service set forth in the terms and conditions of the tariff, as those terms may be changed from time to time, those policies have been implemented without changing the shipper contracts. *Id.* ¶ 53, JA 11. The Commission concluded that it may similarly require pipelines to permit forwardhauls and backhauls, each of which is up to the shipper's contract demand, but with total deliveries in excess of contract demand, by the same approach after making the necessary findings under NGA § 5. *Id.*

SUMMARY OF ARGUMENT

<u>The ROFR Term Cap</u>

To authorize pre-granted abandonment, the Commission must find that the customer is protected from the exercise of market power at the termination of its contract. In connection with ROFR rights, the Commission determined that its current regulatory policies -- the requirement that pipelines sell all available capacity to any shipper willing to pay the maximum FERC-approved rate -- were sufficient to protect existing customers from the exercise of pipeline market power at the termination of their contracts, and there was, accordingly, no need to distort the market with a FERC-imposed cap on the term that could be bid for capacity subject to a ROFR.

Petitioners contend that, without a cap, contract terms will be bid up as a surrogate for FERC-controlled rates where the parties are competing for scarce capacity. As NGA § 7(b) protects consumers from the exercise of pipeline market power, not from all competition for scarce pipeline capacity, the Commission had to determine whether longer length bids in those circumstances reflect actual competition or pipelines' withholding of capacity. Because the Commission requires that pipelines offer all available capacity at the maximum rate, pipelines can only withhold capacity in an effort to drive up contract length (as a surrogate for price) by failing to build new capacity to meet increased demand. As this Court

found in *Process Gas*, however, pipelines have no incentive to follow such a strategy, because the marginal value of the longer term contracts is far outweighed by the benefits of increased revenue that would result from building new capacity to meet increased demand. Thus, where capacity is limited, the bidding up of contract terms in the ROFR process reflects not the exercise of pipeline market power, but legitimate competition for scarce capacity.

Petitioners assert *Process Gas* is distinguishable because it did not involve NGA § 7(b) abandonment protections for existing customers. But NGA § 7(b) protection was provided here through the ROFR itself. If a ROFR shipper is willing to pay the maximum rate for a term equal to that of its rival bidder, then the ROFR shipper is protected from the termination of its existing service. This permits even a captive customer served by a single pipeline to retain its long-term firm transportation service against rival bidders, and therefore provides the protection from pipeline market power required for pre-granted abandonment under NGA § 7(b).

Claims of potential harm to LDCs from bidding for long-term contracts now, when they may lose load in the future, are speculative. Petitioners offered only one unspecified instance of an LDC allegedly experiencing a large loss of retail customers. Nor is it certain that LDCs will lose load in states with retail choice programs because it is unclear whether those states will eliminate LDCs' obligation

to be the supplier of last resort. As this Court found in *UDC*, LDCs are no different from other industry participants in that they have to evaluate future risks in determining how much capacity to reserve. Further, based on the evidence of term lengths while the five-year term cap was in place, it appears unlikely that LDCs will be required to enter into contracts in excess of five years. LDCs with excess capacity can take advantage of the Commission's capacity release program to reduce their costs. In any event, as the bidding up of contract length is not an exercise of market power, but represents legitimate competition for scarce capacity, there is no reason that the scarce capacity should not be allocated to the shipper valuing it the most.

The Commission did not disregard the evidence purportedly showing that the five year cap falls within the zone of reasonableness of three to ten years. That data, however, concerned service on regulated pipelines, and provided no basis for estimating what contract terms would be in a competitive market. Accordingly, in the absence of concern over the exercise of pipeline market power, that evidence did not support what petitioners admit would be an arbitrarily-selected term matching cap. Even assuming that three to ten years was the zone of reasonableness for the cap, there was no reason to assure shippers that their contract term would always be at the lower end of that zone, regardless of the willingness of other shippers to bid longer terms.

Forwardhauls and Backhauls to the Same Point

In Order No. 637, the Commission determined that the failure to permit segmentation where operationally feasible is unjust and unreasonable because it restricts efficient use of capacity without adequate justification, a determination affirmed in *INGAA*, 285 F.3d 18. *INGAA* also affirmed the Commission's related requirement that segmentation must be coupled with flexible point rights to be effective. *INGAA* remanded for further consideration, however, whether shippers should be allowed to forwardhaul and backhaul to the same delivery point, finding that, while the Commission had addressed the operational concerns involved, it had not adequately considered whether this policy modified shipper contracts or required additional findings to support its implementation.

On remand, the Commission reasonably determined that adoption of the forwardhaul/backhaul policy was justified under NGA § 5. Like other segmented transactions, the failure to permit forwardhaul/backhaul transactions where operationally feasible restricts the efficient use of capacity without adequate justification and is therefore unjust and unreasonable. Requiring that pipelines permit forwardhaul/backhaul transactions is just and reasonable because it aids in creating additional supply alternatives for shippers, enhances competition on the pipeline's system and gives shippers the same flexibility that pipelines enjoyed prior to Order No. 636.

The Commission also found that the forwardhaul/backhaul policy does not modify shipper contracts. The backhaul portion of a transaction is scheduled on a secondary basis, and thus does not fall within a shipper's guaranteed right to firm service specified in its service contract. While a pipeline must reserve sufficient capacity at the primary points and intervening mainline to guarantee the specified primary service, there is no such obligation for secondary point rights because they are not specified in a shipper's contract. Accordingly, unlike changes to mainline contract demand levels or primary points, the Commission can treat secondary point rights as rights that can be given to shippers without changing their contracts.

Nor does the forwardhaul/backhaul policy give shippers additional service for which they do not pay. Under Commission policy, because a shipper pays to use all capacity, including all points, within a zone, the shipper may use all points in that zone on a secondary basis. As with any other segmented transaction, therefore, a shipper is entitled to use a secondary point as a delivery point for a backhaul transaction. The pipeline for its part has fully allocated and collected all its zone costs from its shippers through its reservation charge.

Implementation of the forwardhaul/backhaul policy does not require modification of shipper contracts because those contracts include clauses incorporating the terms and conditions in the pipeline's tariff, as modified. While pipelines may negotiate different *rates* with particular customers, Commission

policy prohibits pipelines from negotiating *terms and conditions of service* with particular customers different from those set forth in their tariffs. Thus, the shippers' individual contracts with the pipelines provide for the customer automatically to receive any modified service set forth in the terms and conditions of the tariff, as those terms may be changed from time to time. The Commission need not separately modify individual shipper contracts to implement the forwardhaul/backhaul policy, as the general tariff changes required here are automatically incorporated into the contracts.

Because the forwardhaul/backhaul policy requires no modification of shipper contracts, the *Mobile-Sierra* public interest standard of review does not apply. *Mobile-Sierra* bars tariff revisions that conflict with contracts. Where a tariff revision is consistent with the contract, *Mobile-Sierra* does not apply. Here, implementation of the forwardhaul/backhaul policy is consistent with the shipper contracts because it does not modify the shippers' primary rights to service specified in those contracts, and the contracts expressly provide for the shipper to receive the service set forth in the terms and conditions of the tariff, as those terms may be changed from time to time. Because the contracts anticipate and incorporate future changes in the terms and conditions of service, no violation of the contract or change to the contract occurs when those terms and conditions change.

Likewise, the forwardhaul/backhaul policy does not change certificated service levels in violation of NGA § 7(a). In implementing this policy, the Commission is not compelling pipelines to provide new service; it is changing the terms of existing services and establishing terms for future services.

ARGUMENT

I. STANDARD OF REVIEW

The Court must uphold FERC's orders unless they are "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." *Transcontinental Gas Pipe Line Corp. v. FERC*, 54 F.3d 893, 898 (D.C. Cir. 1995). Judicial scrutiny under the NGA is limited to assuring that the Commission's decisionmaking is reasoned, principled, and based upon the record. *Pennsylvania Office of Consumer Advocate v. FERC*, 131 F.3d 182, 185 (D.C. Cir. 1997). The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. NGA § 19(b), 15 U.S.C. § 717r(b).

II. THE COMMISSION REASONABLY CONCLUDED THAT A ROFR TERM CAP IS NOT REQUIRED TO CHECK PIPELINE MARKET POWER.

A. Consistent with *Process Gas*, Given Current Regulatory Controls, Bidding On Contract Length Reflects Legitimate Competition for Capacity, Not the Exercise of Pipeline Market Power.

To make a "finding of public convenience and necessity for pre-granted abandonment under § 7, the Commission must make appropriate findings that existing market conditions and regulatory structures protect customers from pipeline market power." *UDC,* 88 F.3d at 1139. *See also AGA*, 912 F.2d at 1518 (Commission must explain how pre-granted abandonment protects gas customers

from pipeline exercise of monopoly power through refusal of service at the end of a contract period).

Petitioners contend that elimination of the ROFR term cap, by removing any limits on the length of contract term that a ROFR shipper must match to retain capacity, permits pipelines to exercise market power. Pet. Br. 36-37. FERC disagreed, after a careful analysis of the legal restrictions on and incentives of pipelines to exercise market power in this context, concluding that the bidding on contract terms reflects, not pipeline exercise of market power that would raise concerns under NGA § 7, but, rather, legitimate competition among shippers for scarce capacity, a conclusion affirmed in *Process Gas*, 292 F.3d at 837.

Pipelines can exercise market power by withholding capacity to create an artificial scarcity, thereby raising prices. Remand Order ¶ 11, JA 3. Although aware of that possibility, FERC, following the reasoning of the *Tennessee* Orders and this Court's decision in *Process Gas*, found that existing regulatory controls sufficiently constrain pipelines from withholding capacity as a way to pressure shippers into longer contracts than dictated by competition. Accordingly, there was no need for a term-matching cap. *Id.*

Because pipelines are required to sell all available capacity to shippers willing to pay the maximum FERC-approved rate, they can only create scarcity by refusing to build additional capacity when demand requires it. Remand Order ¶ 12,

JA 3. Given that transportation rates remain regulated, pipelines have a greater incentive to build new capacity to serve added demand than not to build, because only by increasing throughput can a pipeline increase its revenues and profits. *Id*. Further, if a pipeline refuses to build new capacity, shippers can file a complaint. *Id*. Commission regulations prohibit pipelines from favoring or colluding with their affiliates to manipulate the market through sham bids. *Id*.

This reasoning was affirmed in *Process Gas*. "[B]ecause the Commission already regulates the rates pipelines may charge and requires them to sell all available capacity at those rates, we agree with FERC that [the pipeline] has neither the legal ability to withhold existing capacity nor an incentive to refuse to build new capacity." 292 F.3d at 837. Further, "any effort by [the pipeline] affirmatively to manipulate the bidding process would violate other Commission rules and would therefore presumably be actionable." *Id*. Thus, "other regulatory constraints adequately limit [a pipeline's] ability, as well as any incentive, to induce lengthy contracts." *Id*.

Petitioners assert *UDC* found rate regulation insufficient to protect shippers from pipeline market power because the contract term can be bid up as a means to circumvent the inability to bid beyond the maximum rate limit on price. Pet. Br. 44. However, while *UDC* questioned whether the bidding up of contract terms represented an exercise of pipeline market power, Pet. Br. 33, 41 (quoting *UDC*, 88

F.3d at 1140), the Commission and this Court in *Process Gas* answered that question in the negative. Remand Order ¶ 15, JA 4. "[B]ecause the pipelines had no incentive under [the Commission's] regulatory scheme to withhold capacity and exercise market power, the longer terms required to retain existing capacity were justified by the scarcity of current capacity." Rehearing Order ¶ 26, JA 19. Thus, "the fact that shippers may at times bid up contract length likely reflects not an exercise of [the pipeline's] market power, but rather competition for scarce capacity." *Process Gas*, 292 F.3d at 837.

Petitioners, indeed, admit that scarcity is unlikely to arise from the withholding of capacity by pipelines, stating that "the far likelier prospect [is] that scarcity exists simply because there is more demand for pipeline service than capacity." Pet. Br. 36-37. Nevertheless, petitioners assert that, while there may be no pipeline "culpability," the Commission still retains the "responsibility to prevent the exercise of market power by monopolists in control of scarce resources." Br. 37. This misses the mark. The Commission is meeting its responsibility through regulating rates and requiring the sale of all available pipeline capacity at the maximum rate. The willingness of customers to offer longer terms for scarce capacity reflects the higher value they give the capacity, not the exercise of pipeline monopoly power.

Petitioners' argument that the Commission has not shown that ROFR shippers have competitive alternatives, Pet. Br. 42, likewise misses the mark. The point is not whether ROFR shippers have competitive alternatives to a particular pipeline's capacity, but whether longer contract terms represent competition or an exercise of pipeline monopoly power. The Commission determined that longer terms could be expected as a result of competition for scarce capacity, as a means for the market to allocate capacity to the shipper who values it most. *See* Rehearing Order ¶ 26, JA 19.

Petitioners assert that the requirement that pipelines offer all capacity at the maximum rate provides no protection from pipeline market power as "the value of the ROFR comes into play only when there is insufficient pipeline capacity to serve those desiring it." Pet. Br. 45. That is, of course, the reason for creating ROFR rights in the first place. But it does not speak to what conditions are essential to the efficacy of that right. Here, the point of requiring all available capacity to be offered at the maximum rates is to avoid artificial scarcity in capacity arising from pipeline withholding. The requirement assures scarce capacity is not the result of the exercise of pipeline market power. *See Process Gas*, 292 F.3d at 837; Rehearing Order ¶ 26, JA 19. With that assurance, there is no reason for FERC to set a term cap as a way to protect shippers from actual competition.

Pointing to the lead time to construct new capacity, petitioners contend that new capacity provides no "salvation" for the existing customer who may lose capacity to a party willing to bid a longer term. Pet. Br. 37. The Commission did not, however, suggest that construction of new capacity would provide immediate replacement capacity to shippers that failed to exercise their ROFR by matching the highest bid for capacity. Rehearing Order ¶ 26, JA 19. Rather, the fact that pipelines have no incentive to "withhold" by not building needed capacity leads to the conclusion that capacity shortages are not artificially created and, therefore, the longer terms required to retain existing capacity are the result of legitimate competition. *Id.*

Petitioners criticize the Commission's finding that "pipelines have an incentive to build more capacity in all cases where there may be demand" as "simplistic" because pipelines may choose not to construct new capacity where it is not cost-justified or they can achieve higher returns elsewhere. Pet. Br. 37-38. Those are, however, valid reasons not to construct. The Commission was concerned about invalid reasons not to construct, namely, the failure to construct to create scarcity for the purpose of driving up prices. The Commission found that, as withholding capacity would not permit pipelines to increase rates and revenues, Remand Order ¶ 12, JA 3, pipelines have a much stronger incentive to construct new capacity, which would increase rates and revenues, where it is economically

justified. Rehearing Order ¶ 30, JA 20. Further, in the event that a pipeline does attempt to exercise market power by not constructing economically justified capacity, the Commission can provide remedies upon complaint. *Id.*

Petitioners contend that the complaint remedy is "hollow" because "there would simply be no point to filing a complaint to address the problem that is at the root of this appeal." Pet. Br. 46. This cryptic statement apparently references the fact that the shipper competition for scarce capacity of which petitioner complains is not actionable because it is not the product of pipeline market power. That is precisely the point; NGA § 7 protects shippers from the exercise of pipeline market power, not from competition with other shippers.

Petitioners assert that an after-the-fact complaint remedy is a "poor alternative" to structural remedies addressing the monopolistic conduct. Pet. Br. 46. However, FERC found that the current regulatory structure adequately protects against the exercise of pipeline market power without adding a term cap. The complaint remedy does not replace the current regulatory structure, but rather addresses those rare situations in which a pipeline, notwithstanding the regulatory structure, nevertheless attempts to assert market power. Rehearing Order ¶ 30, JA 20. *UDC* rejected similar arguments that the complaint process is inadequate protection for ROFR shippers, finding that the ROFR itself provides the primary protection from pipeline market power, while the complaint process "serves as a

back-up" to the ROFR mechanism. 88 F.3d at 1139 and n. 42. Moreover, while the Commission may not be able to require a pipeline to construct new capacity to serve new demand, Pet. Br. 47, it can certainly fashion other remedies, such as reimposing a term cap, to stop any attempts to exercise market power. *Id.*

Petitioners also assert that a pipeline might use its market power "to achieve other business ends, regulated or unregulated, with its customers." Pet. Br. 38 (citing *Michigan Consolidated Gas Co. v. FPC*, 283 F.2d 204 (D.C. Cir. 1960), and *AGA*, 912 F.2d at 1516). However, *AGA* and *Michigan* addressed situations, unlike the ROFR situation, where there were no rules designed to prevent such abuses. *See* Remand Order n. 32, JA 7. Here, the ROFR rules, established in Order No. 636, prevent a pipeline from requiring shippers to provide special advantages to retain capacity. Rehearing Order ¶ 29, JA 20. A ROFR shipper can retain its capacity by signing the *pro forma* service agreement, which contains no special terms and conditions, at the maximum tariff rate. *Id.* Further, in Order No. 637, the Commission denied pipelines pre-approval of negotiated terms and conditions of service, requiring pipelines to file with the Commission material deviations separately so as to permit Commission review of such deviations. *Id.* In short, the existing regulatory structure prevents pipelines from using power over capacity to extract other advantages.

B. The Fact That *Process Gas* Involved Allocation of Capacity Among New Customers Does Not Change the Result As the ROFR Mechanism Itself Provides the Requisite Protections from Pipeline Market Power Required by NGA § 7(b).

Petitioners contend that *Process Gas* is inapplicable here because it involved the allocation of new capacity, rather than the renewal of existing capacity which is subject to the abandonment protections of NGA § 7(b). Pet. Br. 39. In the first instance, petitioners' characterization is inaccurate because *Process Gas* did involve the allocation of existing capacity; it differed from the case here in that it involved the allocation of capacity among new shippers, not existing shippers to whom NGA § 7(b) protections apply.

Certainly, the Commission recognized that NGA § 7(b) was not at issue in *Process Gas,* while it is here. Rehearing Order ¶ 21, JA 18. However, *Process Gas* did not preclude the Commission from considering the effect of regulatory controls on the need for a term cap in the ROFR process. *Id*. Indeed, the Court observed that "[i]n a series of opinions, we have *questioned the need for* and the proper length of a cap on the duration of such 'right-of-first-refusal bids.'" *Process Gas*, 292 F.3d at 838 (emphasis added). *Process Gas* required only that the ROFR process meet the requirements of NGA § 7(b). Rehearing Order ¶ 21, JA 18.

The Commission fully addressed NGA § 7(b) requirements in eliminating the ROFR term cap. *Id*. ¶ 22, JA 18. The Commission found ROFR protections a

necessary adjunct to pre-granted abandonment because the ROFR assures that, if an existing customer is willing to match the rate and contract term of a rival bidder, the pipeline may not abandon service to that customer. *Id*. The ROFR permits even a captive customer served by a single pipeline to retain its long-term firm transportation service against rival bidders, and therefore provides the protection from pipeline market power required for pre-granted abandonment. *Id*. In addition, other regulatory constraints, like the requirement that pipelines sell all available capacity at just and reasonable rates, prevent pipelines from exercising market power by withholding of capacity. *Id*.

ROFR shippers are, contrary to petitioners' claim, Pet. Br. 40, given an advantage in retaining existing capacity. Under the ROFR, existing shippers are assured of retaining capacity over rival bidders if both bid for the same rate and term, an advantage not enjoyed by shippers bidding for new capacity as in *Process Gas*. The ROFR's assurance of continued service to existing shippers provides the requisite NGA § 7(b) protection from abandonment, permitting finding pre-granted abandonment in the public convenience and necessity. Rehearing Order ¶ 22, JA 18.

C. The Commission Reasonably Concluded the Alleged Harm to LDCs was Speculative.

Petitioners argue that elimination of the term cap will conflict with *Certification of New Interstate Natural Gas Pipeline Facilities*, 88 FERC ¶ 61,227

(1999), pursuant to which the Commission generally sets prices for expansions on an incremental basis, so that existing customers are not called upon to subsidize the new construction. Pet. Br. 47-49. According to petitioners, because incremental rates are higher than existing rates, new customers will bid up the contract terms for existing capacity in an effort to avoid the higher cost of new capacity priced at incremental rates, thereby indirectly shifting some of the cost of the incremental facilities to existing ROFR shippers. *Id*. at 49.

However, the incremental pricing policy does not insulate existing ROFR shippers from the incremental costs of expansion capacity at the termination of their contract under the circumstances that concern petitioners – where the pipeline has different vintages in capacity as a result of incremental pricing that result in different prices for the same service, and the pipeline is full, so that shippers are competing for the capacity held under the ROFR shipper's expiring contract. Order No. 637-A at 31,635-36; *Certification*, 88 FERC at 61,746. Under those circumstances, an existing ROFR shipper must meet the higher incremental rate bid to retain its capacity, even though that rate exceeds the ROFR shipper's historical maximum price. *Id*. This policy reflects the fact that, in those circumstances, the ROFR shipper is just as much a cause of the need for expansion capacity as a new shipper. Order No. 637-A at 31,637.[13] Thus, in circumstances

[13] Under this policy the ROFR shipper remains protected from pipeline

of scarce vintage capacity where the pipeline is fully subscribed, the incremental pricing policy requires that ROFR shippers match competing bids for service. There is no conflict between the incremental pricing policy and the ROFR policy.

Further, given the existing regulatory protection against the exercise of pipeline market power, adding a term cap is not warranted, and could distort the bidding process so that scarce pipeline capacity is not allocated to the shipper placing the highest value on that capacity. Rehearing Order ¶ 17, JA 17. Where competition places a high value on existing capacity, existing shippers may themselves benefit from this increased market value through the capacity release program. *See id*. ¶ 34, JA 21. It cannot, moreover, be assumed that all new pipeline construction results in new capacity that, if priced incrementally, would yield higher rates than the rates applicable to existing capacity.[14]

Petitioners complain that LDCs in states with retail access programs could be injured if they must meet any contract term bid in order to retain capacity

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market power because the pipeline cannot insist on the shipper paying a higher rate unless its expansion is fully subscribed and there is another bid for capacity at a rate above the vintage maximum rate charged the existing shipper. *Id*. at 31,640.

[14] *See Certification*, 88 FERC at 61,744. In many cases, the incremental unit rate related to new capacity would be less than the rolled-in unit rate of existing facilities. *See, e.g., Tuscarora Gas Transmission Co*., 96 FERC ¶ 61,356 at 62,346-8 (2001); *Tuscarora Gas Transmission Co*., 93 FERC ¶ 62,102 (2000); *El Paso Natural Gas Co*., 104 FERC ¶ 61,303 (2003); *Southern Natural Gas Co*., 94 FERC ¶ 61,297 at 62,085 (2001); *Tennessee Gas Pipeline Co*., 92 FERC ¶ 61,009 at 61,019 (2000); *Transwestern Pipeline Co*., 90 FERC ¶ 61,032, at 61,162 (2000).

because they cannot project their requirements beyond a three to five year horizon, after which they may lose significant market share. Pet. Br. 50-51. However, petitioners did not explain why this possibility should entitle existing shippers to retain capacity that another shipper values more highly. Rehearing Order ¶ 33, JA 20. *UDC* rejected a similar claim based on LDC's allegedly vulnerable market situation, finding that "[t]he Commission reasonably responded that LDCs are no different from other industry participants in that they will have to evaluate future risks in determining how much capacity to reserve." *UDC,* 88 F.3d at 1140-41 n. 44 (citing Order No. 636-B at 62,026). As to the fear that LDCs will be locked in to one pipeline under a long-term contract, and thus precluded from contracting with new suppliers or expansion projects, LDCs can hedge against this risk by exercising their ROFR for a volumetric portion of their existing capacity, which would leave them free to contract for other transportation. Rehearing Order ¶ 37, JA 21.

Although petitioners contend that "retail customer conversions can be quite substantial," Pet. Br. 50, petitioners point to only one anecdotal instance of one unnamed LDC that allegedly experienced a large switch in retail customers. Rehearing Order ¶ 36, JA 21. This is insufficient evidence on which to base a finding of generalized harm to LDCs. *Id.* Further, the possible harm of excessively long capacity contracts in such situations is speculative. *Id.* ¶ 35, JA

21. It is not certain that states with retail choice programs will eliminate the obligation of LDCs to be suppliers of last resort, and, if they do, that LDCs so affected will have made contracts for more than five years that will lead to stranded costs. *Id.*

Indeed, despite their claims that removing the five-year cap could require captive customers to match extremely long-term bids, Pet. Br. 54, petitioners argued to the Commission that the five-year term matching cap had not led to shorter contract terms than would otherwise occur, since non-captive customers have generally been able to negotiate contract terms of less than five years. Remand Order ¶ 19, JA 5. For example, AGA, relying on the January 2002 Index of Customer data, for contracts with effective dates after January 1, 1999, showed that 49 percent of the contracts are for less than three years and only 6.4 percent had terms of exactly five years. *Id.* Two parties examined Table 1 of the Commission's May 31, 2002 notice requesting comments, *id.* and n. 18 (citing *Regulation of Short-Term Natural Gas Transportation Services, and Regulation of Interstate Natural Gas Transportation Services*, 99 FERC ¶ 61,245 (2002) (Table 1)), which showed that almost 60 percent of the contracts with terms of five years or less had terms of one to two years, while only about 15 percent had terms of five years, so that the five-year cap was not driving the market. *Id.* *See* Rehearing Order ¶ 35, JA 21 (another study showed that very few contracts with terms of five

years or more were signed each year). If competing customers did not bid up to five years while there was a five-year cap, it seems unlikely bids would be for longer periods once the cap is removed. *Id*.

Finally, LDCs have the option of capacity release as a way to reduce their costs. *Id*. For example, if petitioners' speculation that adoption of retail unbundling leads to customer loss is realized, an affected LDC could release its excess capacity to marketers or other gas providers seeking to serve the same load, thereby obtaining reimbursement of its reservation charges. *Id.* ¶ 34, JA 21. Under Commission policy, that LDC could permanently release its capacity to a qualified and creditworthy shipper, thus extinguishing its contractual obligation to the pipeline. *Id*.

Petitioners assert that the Commission failed to "take evidence" on whether capacity release was "a meaningful mitigating factor," pointing to a statement in *INGAA* that rates for capacity release were, on average, below maximum pipeline rates. Pet. Br. 45 (citing *INGAA*, 285 F.3d at 31). That statement, however, refers to the average of all releases. Petitioners here are concerned with a limited situation of scarce capacity that is sufficiently valuable that shippers are willing to agree to lengthy contract terms in order to acquire it. Such capacity is much more likely to be valuable in the capacity release market than the average of all releases. Rehearing Order ¶ 34, JA 21. In any event, capacity release is not designed to

make LDCs whole, but only to reduce their costs. *Id.* ¶ 35, JA 21. Further, based upon the evidence, there is no support for the assumption that other shippers will insist on terms of more than five years in excess of the LDCs planning "comfort zone." *Id.* ¶ 37, JA 21.

Petitioners contend that, if their concerns are speculative and contracts will not exceed five years, then there was no point in eliminating the matching term cap. Pet. Br. 53. This argument, however, stands the issue on its head. The point of eliminating the cap is to achieve efficient allocation of pipeline capacity, *i.e.* putting capacity in the hands of those who value it the most. Remand Order ¶ 20, JA 5 (quoting *INGAA*, 285 F.3d at 52); Rehearing Order ¶ 17, JA 17. A term cap does not serve this purpose, and should only be imposed if necessary to constrain pipeline market power for the protection of captive customers. Remand Order ¶ 20, JA 5. As that was not necessary here, there is no justification for not fully allocating scarce pipeline capacity to the shipper valuing it most highly. Rehearing Order ¶ 17, JA 17.

D. The Commission Reasonably Rejected Evidence Purportedly Supporting Adoption of a Five-Year Cap.

Petitioners contend that the record evidence supports adoption of a five-year cap, as the five-year period falls within a purported zone of reasonableness for contract terms of three to ten years. Pet. Br. 54-60. According to petitioners, the record data demonstrated that more contracts had been entered into between 1992

and 2002 for five and ten years than for terms of any other length, the mean term of all contracts was 4.72 years and the median was three years, resulting a zone of reasonableness of three to ten years reflecting the term for most contracts. Pet. Br. 55-56.

However, "[g]iven that the term cap is not needed to prevent pipelines from exercising market power, the Commission [found] that the factual data on contract terms provides little factual basis for establishing a cap on contract length different from that established by the competition among buyers for the capacity." Rehearing Order ¶ 17, JA 17. The available data was derived from service on regulated pipelines, and could not serve as an estimate of what contract terms would be in a truly competitive market. Remand Order ¶ 18, JA 4. Further, the data show a range of contract terms, which is consistent with the view that a competitive market would not produce one generally applicable contract term. Rehearing Order ¶ 17, JA 17. *Process Gas* agreed with the Commission that, absent a widespread competitive market for primary pipeline capacity, there was no way of estimating what contract term a competitive market would produce, and, therefore, any term cap would be an arbitrary figure distorting efficient operation of the market by preventing a shipper who is willing to offer a longer contract term from doing so. *Process Gas*, 292 F.3d at 837 (quoting *Tennessee*, 94 FERC at 61,399). Petitioners themselves concede that any term cap "would inevitably need

to be a ‘somewhat arbitrary figure.’” Pet. Br. 55 (quoting *UDC*, 88 F.3d at 1141, n.45).

While petitioners assert that the competitive market result is not an appropriate benchmark for the term cap, contending that under such a standard “rate regulation should simply be eliminated entirely,” Pet. Br. 57-58, the goal in rate regulation is to mimic the results that would be achieved in a competitive market. “Rate ceilings are set at the Commission’s estimate of cost, *thus roughly paralleling what would occur in a competitive market*.” *INGAA*, 285 F.3d at 55 (emphasis added). Specifically, this Court has recognized that the term matching cap is designed to replicate the contract term that would obtain in a competitive market. *Process Gas*, 292 F.3d at 837. The Commission has not overlooked “its core responsibility [] to protect customers from the exercise of monopoly power,” Pet. Br. 57, because customers are adequately protected by other regulatory controls, rendering a term cap unnecessary.

Even assuming the evidence showed a three to ten year zone of reasonableness for contract terms, such evidence does not support selecting a five-year term cap. Rehearing Order ¶ 42, JA 22. In *INGAA*, the Court remanded the five-year cap to the Commission in part because the Commission failed to address its own concerns that setting the term cap at the median contract length of five years could produce significant market distortion. *INGAA*, 285 F.3d at 52 (citing

Regulation of Short-Term Natural Gas Transportation Services, Notice of Proposed Rulemaking, 63 Fed. Reg. 42982, FERC Stats. & Regs., 1988-1998 ¶ 32,533 (1998) ("NOPR")). Remand Order ¶¶ 16, 17, JA 4; Rehearing Order ¶ 43, JA 22. The NOPR expressed concern that the five-year cap provides a disincentive for existing shippers to enter into contracts of more than five years, resulting in a bias toward short-term contracts and an imbalance of risk between pipeline and ROFR shipper. NOPR, 63 Fed. Reg. at 43,016. While petitioners question the risks posed to pipelines from the term cap, Pet. Br. 59, the NOPR explained that, as a practical matter, the five-year cap gives current customers the incentive to opt for as short a contract term as possible so that, at contract expiration, they can reassess the value of the capacity and decide if it is in their interest to keep it. *Id.* If pipeline capacity is relatively valuable, there are likely to be other shippers interested in long-term contracts, but the existing shipper will exercise its ROFR and retain the capacity for a five-year term. *Id.* On the other hand, if the market value of long-term capacity is low, the existing shipper can terminate the contract with no obligation to the pipeline. *Id.*

Thus, there is no reason for a ROFR shipper to enter into a long-term contract because it can use a series of short-term contracts to obtain long-term service, and wait and see how the market develops. This results in an imbalance of risks between pipelines and existing shippers, as the pipeline is obligated to

provide service for the shipper indefinitely, as long as it exercises its ROFR, while the shipper has no corresponding long-term obligation to the pipeline. *Id.*

Eliminating the term-matching cap, on the other hand, would address the *INGAA* concerns that a term matching cap allows customers to hold pipelines to a perpetual service commitment with no corresponding protection for the pipeline from ultimately being left with stranded capacity; and does not put capacity in the hands of those who value it most. Remand Order ¶¶ 16, 17, JA 4; Rehearing Order ¶ 43, JA 22; *INGAA*, 285 F.3d at 52-53. Removing the term matching cap also eliminates the concern that a five-year cap would result in a bias toward shorter-term contracts. Remand Order ¶ 17, JA 4; Rehearing Order ¶ 17, JA 17; *INGAA*, 285 F.3d at 52-53.

Petitioners assert that, if the Commission found the five year median too low, it could have chosen another figure "<u>somewhere</u> in the zone of reasonableness." Pet. Br. 58 (emphasis in original). However, as discussed above, a competitive contract term is very difficult to estimate in the absence of any widespread competitive market for primary pipeline capacity. Remand Order ¶ 18, JA 4; Rehearing Order ¶¶ 17, 43, JA 17, 22; *Process Gas*, 292 F.3d at 837. As the term cap is not required to provide protection from pipeline market power, there is no ground for the Commission to impose an arbitrary term cap on competitive bidding for pipeline capacity.

While petitioners assert that average and median term caps were "relatively stable" both before and after adoption of the five year cap, Pet. Br. 59, this is consistent with the Commission's finding that current regulatory controls are sufficient to minimize pipeline's incentive to exercise monopoly power to create an artificial scarcity of capacity, so as to force shippers to bid longer contract terms than the market would require. Rehearing Order ¶ 42, JA 22. Petitioners' assertion that this "begs the question" of why the Commission "feels no need to step in to assist those other customers who are required to sign longer-term agreements," Pet. Br. 58, again misses the point that further § 7 protections are not required, particularly when they may distort the market.

III. THE COMMISSION REASONABLY CONCLUDED THAT ITS FORWARDHAUL/BACKHAUL POLICY DOES NOT MODIFY SHIPPER CONTRACTS AND THAT IMPLEMENTATION OF THE POLICY THROUGH PIPELINE TARIFFS WAS FULLY JUSTIFIED UNDER § 5.

INGAA upheld the determination under NGA § 5 that pipelines' failure to permit segmentation when operationally feasible was unjust and unreasonable, 285 F.3d at 37-39, as well as the corollary determination that flexible point rights were required to implement segmentation, *id*. at 39-40. *INGAA* also upheld implementing this policy through pipeline *pro forma* tariff filings, *id*. at 37-38, and rejected the argument that flexible point rights increase shipper transportation rights beyond their contractual scope, *id*. at 39-40.

As one specific application of this policy, the Commission held in Order No. 637-A that pipelines must allow a shipper to engage in forwardhauls and backhauls to the same delivery point, as long as the capacity moved on the mainline in any segment does not exceed a shipper's mainline contract demand. Order No. 637-A at 31,592-93. While Tennessee contends, Pet. Br. 61-62, 70, that *INGAA* found that the forwardhaul/backhaul policy modified shipper contracts, in fact *INGAA* remanded the forwardhaul/backhaul determination because the Commission orders failed to address the issue of whether this policy modified shipper contracts. *INGAA*, 285 F.3d at 41; Rehearing Order ¶ 79, JA 28.

In the challenged orders, the Commission fully responded to the *INGAA* remand by explaining why the forwardhaul/backhaul policy did not result in the modification of shipper contracts. Rehearing Order ¶¶ 79, 80, JA 28. Because backhauls are scheduled at a delivery point on a secondary basis, permitting a shipper's backhauls to the same point as its forwardhaul does not increase the firm primary service guaranteed and specified in the shipper's contract. Remand Order ¶ 48, JA 10. The forwardhaul/backhaul policy, like segmentation/flexible point rights generally, was implemented by requiring pipelines to file revised tariff sheets expressly permitting such forwardhaul/backhaul transactions. *Id.* ¶ 58, JA 12. Because modifications to a pipeline's tariff terms and conditions of service are automatically incorporated by reference in pipeline *pro forma* service agreements

with shippers, *id.* ¶¶ 47, 53, JA 10, 11, no modification to shipper contracts was required to implement this policy, and no *Mobile-Sierra* issue was raised, *id.* ¶ 46, JA 10. The Commission determined that the tariff modifications were fully justified under NGA § 5 for the same reasons as segmentation/flexible point rights; restricting segmentation where operationally feasible restricts efficient use of capacity without adequate justification, whereas permitting such transactions creates additional supply alternatives for shippers and enhances competition on the pipeline. *Id.* ¶ 54, JA 11.

Petitioner Tennessee challenges each of these findings. None of the challenges have merit.

A. The Commission's Implementation of its Forwardhaul/Backhaul Policy Was Well Supported under NGA § 5.

In the challenged orders, the Commission reaffirmed that its segmentation policy permits a segmented transaction consisting of a backhaul up to contract demand and a forwardhaul up to contract demand delivered to the same delivery point. Remand Order ¶ 39, JA 8. To implement this policy, pipelines were required to file revised tariff sheets that expressly permit such transactions. *Id.* ¶ 58, JA 12. The Commission made the requisite NGA § 5 findings to warrant a change in pipelines' tariffs. Remand Order ¶ 54, JA 11; Rehearing Order ¶ 72, JA 27.

In Order No. 636, the Commission observed that much of the pipeline capacity reserved for firm transportation was not being utilized. *UDC*, 88 F.3d at 1149. To increase use of that capacity, FERC created a secondary transportation market (capacity release) where holders of unutilized firm capacity rights could resell them in competition with unsubscribed capacity held by pipelines. *Id*. This capacity release program promotes efficient load management and, therefore, efficient use of pipeline capacity on a firm basis throughout the year. *Id.*

The Commission found generally in Order Nos. 636 and 637 that shippers should have secondary rights to use all receipt and delivery points available in the zones for which they are paying, as the rates paid reflect the entire cost of the zones. Rehearing Order ¶ 74, JA 27. Order No. 636 required that shippers have the same flexibility to use their firm transportation capacity that pipelines enjoyed when they provided bundled sales service. The ability to use capacity flexibly, through the use of flexible point rights and of segmentation, had long been enjoyed by pipelines. Remand Order ¶ 55, JA 12. As pipelines could forwardhaul and backhaul gas to the same delivery point when they performed bundled sales service, shippers should have that flexibility today. *Id*. Giving shippers that flexibility furthered the goal of creating more competition in the transportation market, including competition between capacity release and the pipeline's sale of interruptible and short-term firm service. *Id*. More competition was expected to

promote the maximum efficient usage of the pipeline system, the development of market centers, and the achievement of a meaningful capacity release program. Rehearing Order ¶ 74, JA 27 (citing Order No. 636-A at 30,582).

Consistent with those goals, Order No. 637 found failure to permit segmentation where operationally feasible is unjust and unreasonable because it restricts efficient use of capacity without adequate justification. Rehearing Order ¶ 74, JA 27; Remand Order ¶ 54, JA 11 (citing Order No. 637 at 31,304; Order No. 637-A at 31,591). On the other hand, permitting segmented transactions is just and reasonable because it creates additional supply alternatives for shippers and enhances competition on the pipeline's system. *Id.* *INGAA* affirmed those findings. 285 F.3d at 38-39.

A forwardhaul and backhaul to the same point that exceeds a shipper's maximum contract demand at the point is a type of segmented transaction. Remand Order ¶ 54, JA 11. The Order No. 636 and 637 segmentation findings apply to and support the forwardhaul/backhaul policy. Rehearing Order ¶ 74, JA 27. Thus the failure to permit segmented backhaul/forwardhaul transactions where operationally feasible restricts efficient use of capacity without adequate justification, and is unjust and unreasonable. Rehearing Order ¶ 75, JA 27. Requiring that pipelines permit backhaul/forwardhaul transactions is just and reasonable because they create additional supply alternatives for shippers, enhance

competition on the pipeline's system, and give shippers the same flexibility the pipeline enjoyed prior to Order No. 636. *Id*. The Commission has fulfilled the requirements that it make NGA § 5 findings concerning its backhaul/forwardhaul policy based on substantial evidence. *Id*.

Tennessee argues that implementing the forwardhaul/backhaul policy means pipelines will receive less interruptible, overrun, and short-term firm revenues than "may have been contemplated" when their rates were designed. Pet Br. 74. If that occurs, a pipeline is free to file a new NGA § 4 rate case in which more of its costs would be allocated to firm service.[15] Rehearing Order ¶ 68, JA 27 (citing Order No. 636-B, 61 FERC at 61,997); Remand Order ¶ 56, JA 12. Tennessee nevertheless speculates that pipelines may not be fully compensated for the lost revenue in a new rate case, and a rate case may shift increased costs onto captive customers. Pet. Br. 75-76.

The rate effect of forwardhaul/backhaul transactions is no different from the rate effect of any other segmented transaction, which this Court already has found fully justified under NGA § 5. *INGAA*, 285 F.3d at 39. Moreover, the claim that pipelines will not be fully compensated in a new rate case is speculative. As a

[15] As noted earlier, interruptible, overrun, and short-term revenues are credited to a pipeline's cost of service. A drop in those revenues would reduce the credit, which, in turn, would increase the cost of service allocated to firm customers.

pipeline's own estimate of these revenues is included in its new rate case filing, generally the pipeline has every incentive to assure that it is fully compensated. As for captive customers, the Commission's segmentation and flexible point rights policies, including the forwardhaul/backhaul policy, benefit shippers, including captive shippers, through competition, additional supply alternatives, Rehearing Order ¶ 75, JA 28, and specifically through the ability to profit from the resale of their own excess capacity. This could mean, for example, that even if a pipeline's rate to captive customers increases, that increase may be offset by larger capacity release revenues received by the customer.

B. Implementation of the Forwardhaul/Backhaul Policy Does Not Modify Pipeline Contracts with Shippers.

1. The Policy Does Not Alter the Specified Contract Demand or Give Shippers Rights to Additional Contract Demand for Which They Have Not Paid.

Tennessee's argument that the forwardhaul/backhaul policy modifies shipper contracts turns on the notion that the policy increases the maximum daily quantity ("MDQ") (*i.e.* the contract demand) that a shipper is entitled to receive under its contract because it permits shippers to deliver in excess of the MDQ at a particular point. Pet. Br. 60-61. However, "the backhaul/forwardhaul policy affects secondary point rights, not primary point rights, and [], consequently, it does not modify the contractual amounts terms (MDQ) in shippers' contracts." Rehearing Order ¶ 57, JA 25.

Shippers' service agreements specify shippers' guaranteed firm right to service, *i.e*. the contract specifies that the pipeline will transport up to a specified contract demand (MDQ) from specified primary receipt points to specified primary delivery points. Rehearing Order ¶ 57, JA 25; Remand Order ¶ 48, JA 10; *Transcontinental Gas Pipeline Corp*., 104 FERC ¶ 61,171 ¶¶ 24, 25 (2003) (cited Rehearing Order ¶ 45 and n. 54). The pipeline must reserve sufficient capacity at the primary points and the intervening mainline to guarantee the firm service specified in the contract. *Transcontinental*, 104 FERC ¶ 24. While Commission policy allows shippers to change their primary points, they can do so only if there is sufficient unsubscribed capacity available that the pipeline can guarantee firm service at the new point and the change does not reduce the reservation charges due to the pipelines. *Id*. Because the primary points are specified in the contract, and the pipeline must reserve capacity to serve a shipper at those points, an existing shipper's change from one primary point to another point requires a change in its contract with the pipeline. *Id*.

FERC policy requires that firm shippers be permitted on a secondary basis to use all other points in the zones for which they pay reservation charges. *Id.* ¶ 25. Unlike service at a primary point, a shipper has no guaranteed firm right to use a secondary point because shippers using that point as their primary point have priority. *Id*. Because secondary points are not specified in the contract, and the

pipeline need not reserve capacity to be able to serve a firm shipper at a secondary point, the Commission has treated secondary point rights as rights that can be given to a shipper without changing its contract. *Id.* (citing Remand Order, 101 FERC at 61,527-29).

Thus, under Commission policy, a backhaul is a secondary service, which is available only if operationally feasible, that does not increase the amount of primary firm guaranteed deliveries the pipeline must make. Rehearing Order ¶ 58, JA 25; Remand Order ¶ 42, JA 9 (citing *Tennessee Gas Pipeline Co*., 99 FERC ¶ 61,017 at 61,064-65 (2002)). Because backhauls do not obligate the pipeline to provide firm primary service beyond that set forth in the pipeline's contracts with its firm shippers, or otherwise affect shippers' firm primary rights to deliveries, backhaul transactions do not modify the MDQ terms in pipeline contracts. Rehearing Order ¶ 58, JA 25. Accordingly, the fact that a backhaul transaction is scheduled on a secondary basis does not simply address, as Tennessee suggests, Pet. Br. 65, operational issues regarding the availability of capacity, but also demonstrates why the forwardhaul/backhaul policy can be implemented without modifying the guaranteed firm service terms of shipper contracts. Rehearing ¶ 58, JA 25.

Tennessee nonetheless argues, Pet. Br. 60-61, 65-66, that shippers are getting more than the MDQ for which they pay under the forwardhaul/backhaul

policy, which will "send false price signals to the market," *id*. 72, result in artificially low capacity prices, *id*. 72-73, and reduce pipeline revenues. *Id*. 73-74. *See also id*. 76-77. This fails to recognize that firm shippers pay all the pipeline's fixed costs, including its rate of return, in the zone-wide reservation charges associated with the primary firm capacity. Rehearing Order ¶ 67, JA 26. As pipeline rates are designed to be fully compensatory based on the recovery of fixed costs through reservation charges associated with primary firm capacity rights and variable cost recovery through volumetric charges, *id*., shippers using secondary point rights in the zone have already paid the fixed costs for all points in the zone through their reservation charge.

Accordingly, it is not inequitable for a shipper to use all the points on a secondary basis in a zone because the shipper must pay its allocated share of the costs of the entire zone. Rehearing Order ¶ 68, JA 27; Remand Order ¶ 56, JA 12. The general principle that firm shippers should be able to make full use of their pipeline capacity applies equally to backhaul arrangements as to any other segmented transaction. Rehearing Order ¶ 68, JA 27 (citing Order No. 636-B, 61 FERC at 61,997); Remand Order ¶ 56, JA 12. As shippers pay the entire zone costs based on their capacity demand, a shipper is getting no more than the capacity for which it pays when it is allowed to use (on a secondary basis) all zone

points. *Id.* For its part, the pipeline has fully allocated all zone costs, and is collecting the full amount due from its shippers. *Id.*

Indeed, the Commission's segmentation policy, as affirmed in *INGAA*, already permits shippers engaging in segmented transactions to take deliveries in excess of their contract demand, so long as the mainline demand does not exceed that specified in the contract. Rehearing Order ¶ 59, JA 25; Remand Order ¶ 57, JA 12. For example, in a segmented transaction consisting of two forwardhauls, while a shipper may not exceed its contract demand on any mainline segment, it may take deliveries in each segment up to contract demand, so that total deliveries exceed its contract demand. Rehearing Order ¶ 59, JA 25. Assume a shipper has a contract demand of 100 Dt from points A to C, with primary delivery point rights of 100 Dt at point C, which the shipper could segment from A to intervening secondary point B, and B to C. *Id.* The shipper could then take delivery of 100 percent of its contract demand in each segment, with deliveries at B depending on secondary point rights. *Id.* The combined deliveries would total 200 Dt, while the shipper's contract demand is 100 Dt. *Id.* Substituting a backhaul from C to B produces the same result. In both sets of transactions, the shipper's combined deliveries exceed its mainline contract demand, but deliveries made on a primary basis do not exceed contract demand. *Id.*[16] The key point in both situations is that

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[16] Thus, Tennessee errs in asserting that "the MDQ defines the total amount

deliveries in excess of contract demand take place, if at all, on a secondary basis, so the pipeline is not required to provide greater primary firm service than required in its contract. Rehearing Order ¶ 60, JA 25.[17]

2. The Forwardhaul/Backhaul Policy Does Not Modify Contracts Because the Contracts Expressly Incorporate the Terms and Conditions of the Pipeline Tariffs.

Implementation of the forwardhaul/backhaul policy also does not require modification of shipper contracts because those contracts incorporate by reference any changes in the tariff terms and conditions of service. Remand Order ¶ 44, JA 9.

As required by 18 C.F.R. § 154.110, pipeline tariffs must include *pro forma* service agreements, which set forth the standard terms for all pipeline contracts. *Id*. ¶ 45, JA 9. These *pro forma* service agreements contain provisions incorporating the terms and conditions in the pipeline's tariff into the service agreement, as well as clauses allowing the pipelines to change their rates, rate schedules, and terms and conditions of service by making unilateral NGA § 4 filings. *Id*. Under Commission policy, pipelines are prohibited from negotiating

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of gas that a shipper can take, regardless of scheduling priority, without paying additional charges." Pet Br. n. 108.

[17] In fact, it can be argued that combining a segmented backhaul to the same point with a segmented forwardhaul is less burdensome on the pipeline than two segmented forwardhaul transactions because the forwardhaul/backhaul transaction may use less mainline capacity. Rehearing Order ¶ 61, JA 25.

different terms and conditions of service with particular customers from those set forth in their generally applicable tariffs and *pro forma* service agreements. *Id.* (citing Order No. 637 at 31,342-44; Order No. 637-A at 31,647-48).

As shippers' individual contracts with the pipelines incorporate the terms and conditions of the pipeline's tariff, as those terms may be changed from time to time, *id.* ¶ 53, JA 24, shippers automatically receive any increased rights resulting from tariff changes that are approved as just and reasonable under NGA §§ 4(e) and 5(a). *Id.* ¶ 46, JA 23. The Commission need not modify any term in the individual service agreements between pipelines and their shippers to implement the tariff changes, since the service agreements incorporate the terms and conditions of the tariff. *Id.* ¶ 47, JA 23. Therefore, contrary to Tennessee's assertion, Pet. Br. 62, the tariff change here met the NGA § 5 requirements and did not require modification of shipper contracts. Rehearing Order ¶ 75, JA 27.

C. The *Mobile-Sierra* Public Interest Standard Does Not Apply to Implementation of the Forwardhaul/Backhaul Policy.

Because implementation of the forwardhaul/backhaul policy is consistent with the *pro forma* shipper contracts, the *Mobile-Sierra* public interest standard, Pet. Br. 66-69, does not apply. Rehearing Order ¶ 82, JA 28-29. *Mobile-Sierra* "bars agencies from giving effect to unilateral tariff revisions that violate intercarrier contracts." *MCI Telecommunications Corp. v. FCC*, 822 F.2d 80, 87 (D.C. Cir. 1987). *See also Vermont Dept. of Public Serv. v. FERC*, 817 F.2d 127,

134 (D.C. Cir. 1987) (*Mobile-Sierra* precludes tariff filings that are inconsistent with the terms of a contract governing the relationship between the pipeline and its customers); *Cities of Bethany v. FERC*, 727 F.2d 1131, 1143-44 (D.C. Cir. 1984) (same). Conversely, where the tariff revision at issue is consistent with the contract, there is no change to the contract and *Mobile-Sierra* does not apply. *Vermont*, 817 F.2d at 139; *MCI*, 822 F.2d at 87. *Cf. Delmarva Power & Light v. FERC*, 671 F.2d 587, 595 (D.C. Cir. 1982) (where there is no violation of an underlying contractual obligation, *Mobile-Sierra* does not apply).

The forwardhaul/backhaul policy is consistent with the pipeline/shipper contracts because it does not modify the shippers' specified primary rights. Rehearing Order ¶ 51, JA 24. *See, e.g., Exxon Mobil Corp. v. FERC*, 315 F.3d 306, 311 (D.C. Cir. 2003) (citing the Remand Order for the proposition that the Commission can increase shippers' secondary point rights without modifying individual service agreements). Further, shippers' contracts expressly provide for shippers to receive the service set forth in the tariff, as its terms may be changed from time to time. Remand Order ¶ 53, JA 24.[18] Because the contracts anticipate

[18] For example, a Texas Eastern service agreement provides that its service agreement "in all respects shall be and remain subject to the applicable provisions of Rate Schedule FT-1 and of the General Terms and Conditions of [Texas Eastern's] FERC Gas Tariff on file with the Federal Energy Regulatory Commission, all of which are by this reference made a part" of the service agreement. Rehearing Order ¶ 64, JA 26 (citing Article III, Form of Service

and incorporate future changes in the terms and conditions of service, no violation of the contract or change to the contract occurs when those terms and conditions change. *Memphis*, 358 U.S. at 112 (changes anticipated by the contract do not abrogate the contract and therefore do not implicate *Mobile-Sierra*); *Exxon Corp. v.* FERC, 206 F.3d 47, 51-52 (D.C. Cir. 2000) (where contract contemplates future rate filings and any just and reasonable rates that result from such filings, a future rate filing does not abrogate or modify the contract under *Mobile-Sierra*); *Union Pacific Fuels v. FERC*, 129 F.3d 157, 159 (D.C. Cir. 1997) (where contracts anticipate rate changes, *Mobile-Sierra* did not apply to orders imposing rate changes). Accordingly, all pipeline service agreements are subject to the general terms and conditions of the pipeline tariff, and the Commission may, and has, properly changed the terms and conditions of pipeline tariffs by making findings under NGA § 5 that prohibiting forwardhaul/backhaul transactions is unjust and unreasonable, and requiring tariffs to be amended to specifically permit such transactions. Rehearing Order ¶ 64, JA 26.

Tennessee argues that pipelines can enter into negotiated rate agreements with shippers, and those negotiated rates may be protected by *Mobile-Sierra*. Pet. Br. 67-68 (citing *Natural Gas Pipeline Negotiated Rate Policies and Practices, Modification of Negotiated Rate Policy*, 104 FERC ¶ 61,134 (2003)). While

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Agreement for Rate Schedule FT-1, Original Sheet No. 818, Texas Eastern Transmission, LP, FERC Gas Tariff, Seventh Revised Volume No. 1).

pipelines may negotiate rates, however, as Tennessee's cited authority clearly states, pipelines are prohibited from negotiating the terms and conditions of service. *Natural Gas Pipeline Negotiated Rate Policies*, 104 FERC at ¶ 2. *See* Remand Order ¶ 45, JA 9 ("Commission policy, as stated in Order No. 637, prohibits pipelines from negotiating different terms and conditions of service with particular customers than are set forth in their generally applicable tariffs and form of service agreement," citing Order No. 637 at 31,342-44; Order No. 637-A at 31,647-48). As the forwardhaul/backhaul policy here does not implicate primary rights to service, such as the rate, MDQ, primary receipt and delivery points,[19] it is a term and condition of service that cannot be negotiated by pipelines. Accordingly, there are no negotiated terms and conditions of service subject to *Mobile-Sierra* protections, as Tennessee suggests, Pet. Br. 67.

Even if there could be negotiated terms and conditions of service, under *Memphis*, 358 U.S. at 112, parties can negate *Mobile-Sierra* protections by expressly providing that contract provisions can be overridden by FERC at any time under the just and reasonable standard. Rehearing Order ¶ 84, JA 29. Here, the *pro forma* service agreements uniformly include clauses allowing pipelines to change their rates and terms and conditions of service by unilateral filings at the

[19] Negotiated rate agreements can include price, the term of service, designation of primary receipt and delivery points, and quantity. Order No. 637 at 31,343.

Commission. Remand Order ¶ 45, JA 9. While Tennessee contends that these *Memphis* clauses permit only pipeline-initiated changes, Pet. Br. 68, such clauses evidence a broader intent that all FERC review be conducted under the just and reasonable standard. For example, in *Union Pacific*, 129 F.3d at 159, after adoption in Order No. 636 of straight fixed variable rate design, the Commission required a pipeline to change two shipper contracts with modified fixed variable rate design. The disputed contracts contained *Memphis* clauses permitting the pipeline to request rate changes from FERC. *Id*. at 161. The Court found that those clauses permitted FERC to order the contractual changes under NGA § 5 without meeting the *Mobile-Sierra* standard because the contract expressly contemplated rate changes by FERC without limiting FERC's rights to make rate changes under NGA § 5 to the *Mobile-Sierra* standard. *Id*. Similarly, here, *Mobile-Sierra* does not apply because the contract specifically anticipates changes in rates and terms and conditions of service, and does not preclude the Commission's exercise of NGA § 5 just and reasonable review authority.

Tennessee claims that the Commission's finding here is contrary to *El Paso Natural Gas Co*., 99 FERC ¶ 61,244 at 62,004-05 (2002), *on reh'g*, 104 FERC ¶ 61,045 (2003), *on reh'g*, 106 FERC ¶ 61,233 (2004), *aff'd, Arizona Corp. Comm'n v. FERC*, No. 03-1206 slip op. (D.C. Cir. Dec. 28, 2004). Pet. Br. 68-69. In *El Paso*, certain shippers had contracts that required the pipeline to deliver the

shipper's full natural gas requirements each day. *El Paso*, 99 FERC at 61,998. The Commission found those full requirements contracts unjust and unreasonable and contrary to the public interest because exponential growth in the requirements was causing severe degradation of all firm service on the pipeline. *Id.* at 61,997-98. The Commission required the firm requirements contracts to be converted to contract demand arrangements, which provide for specific delivery rights up to specified quantity limitations at delivery points designated in the contract. *Id.* at 61,997-98. Thus, in *El Paso*, the Commission modified the shippers' contractual entitlements to primary firm guaranteed service. That decision is inapposite here, where shippers' contractually-specified primary rights have not changed. Here, no modifications to shipper contracts were needed, and secondary rights were addressed.

In Order No. 636, the Commission implemented policies concerning firm shippers' rights to use points on a secondary basis by modifying pipeline tariffs under NGA § 5, which was not considered to modify improperly shippers' individual service agreements, nor were those modifications challenged in the appeal of Order No. 636. Remand Order ¶¶ 49-50, JA 10-11. *INGAA* found that the Order No. 637 segmentation and flexible point rights did not abrogate existing contractual rights, and could be implemented by tariff rules. *INGAA*, 285 F.3d at 39; Remand Order ¶ 51, JA 11. The forwardhaul/backhaul policy further continues

flexible point rights and segmentation policies, and thus it can also be implemented via tariff rules that modify a pipeline's general terms and conditions of service under NGA § 5. Remand Order ¶ 53, JA 11. Such tariff modifications are automatically incorporated into customers' individual contracts. Accordingly, it has not been necessary to change the individual contracts, nor has the Commission done so. *Id*. Because contracts did not have to be abrogated and the implementation was via tariff rules, the Commission properly acted under NGA § 5 in requiring pipelines to revise their terms and conditions of service to permit forwardhauls and backhauls to the same delivery point. *Id*.

D. Because the Forwardhaul/Backhaul Policy Does not Modify Contract Quantities, the Challenged Orders Did Not Change Certificated Service Levels.

Tennessee argues that the Commission's forwardhaul/backhaul policy permits shippers to exceed their certificated service entitlements as reflected in their MDQs, which is beyond the Commission's statutory authority under NGA § 7(a). Pet. Br. 77-79. Again, as the Commission did not alter shippers' specified service entitlements, the forwardhaul/backhaul policy did not alter pipelines' certificated service levels by changing the quantity provisions of their transportation contracts. Rehearing Order ¶ 89, JA 30. Order No. 636 rejected the same arguments concerning NGA § 7 because the Commission was not compelling new service; it was changing the terms of existing services and establishing the

terms for future services. *Id.* Section 7(a) applies only to new service; it does not prevent the Commission from requiring changes in terms of existing service. *Id.*

CONCLUSION

For the reasons stated, the Commission's orders should be affirmed in all respects.

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D.C. Cir. Nos. 04-1094, *et al*.

CERTIFICATE OF COMPLIANCE

In accordance with Circuit Rule 28(d)(1) and this Court's order of September 24, 2004, I hereby certify that this brief contains 17,610 words, not including the tables of contents and authorities, the certificate of counsel, this certificate and the addendum.

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