ORAL ARGUMENT HAS NOT YET BEEN SCHEDULED

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

Nos. 06-1006 & 06-1010 (Consolidated)

ILLINOIS MUNICIPAL GAS AGENCY, *et al.*,
PETITIONERS,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
RESPONDENT.

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

BRIEF FOR RESPONDENT FEDERAL ENERGY REGULATORY COMMISSION

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FINAL BRIEF: APRIL 18, 2007

CIRCUIT RULE 28(a)(1) CERTIFICATE

A. Parties and Amici

The parties before this Court are identified in the briefs of Petitioner.

B. Rulings Under Review

1. *Policy for Selective Discounting By Natural Gas Pipelines,* Docket No. RM05-2-000, "Order Reaffirming Discount Policy And Terminating Rulemaking Proceeding," 111 FERC ¶ 61,309 (May 31, 2005) ("Reaffirmation Order"), R. 49, JA 1; and

2. *Policy for Selective Discounting By Natural Gas Pipelines,* Docket No. RM05-2-001, "Order Denying Rehearing," 113 FERC ¶ 61,173 (November 17, 2005) ("Rehearing Order"), R. 55, JA 29.

C. Related Cases

The following case seeks review of Federal Energy Regulatory Commission orders pertaining to specific contracts between an interstate pipeline and certain of its shippers, and relate to, in part, the Commission's policy on selective rate discounting:

- *Midwest Region Gas Task Force Association v. Federal Energy Regulatory Commission*, D.C. Cir. Nos. No. 05-1468 and 06-1016 (consolidated; briefing underway).

Michael E. Kaufmann
Attorney

April 18, 2007

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GLOSSARY

1989 Rate Design Policy Statement or Policy Statement	*Interstate Natural Gas Pipeline Rate Design,* 47 FERC ¶ 61,295, *order on reh'g,* 48 FERC ¶ 61,122 (1989)
FERC or Commission	Federal Energy Regulatory Commission
Gas-on-Gas Competition	Competition between gas pipelines (as opposed to competition between gas and other fuels)
IMGA	Illinois Municipal Gas Agency
Notice of Inquiry	Notice of Inquiry, *Policy for Selective Discounting By Natural Pipelines,* Docket Nos. RM05-2-000, RM97-7-000, 109 FERC ¶ 61,202 (November 22, 2004), R. 1, JA 77-91
NGA	Natural Gas Act
Petitioners	Illinois Municipal Gas Agency, Northern Municipal Distributors Group and Midwest Region Gas Task Force Association
Reaffirmation Order	*Policy for Selective Discounting By Natural Gas Pipelines,* Docket No. RM05-2-000, "Order Reaffirming Discount Policy And Terminating Rulemaking Proceeding," 111 FERC ¶ 61,309 (May 31, 2005), R. 49, JA 1-28
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RESPONDENT.

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

BRIEF FOR RESPONDENT
FEDERAL ENERGY REGULATORY COMMISSION

STATEMENT OF THE ISSUES

1. Whether this Court has jurisdiction to review the Federal Energy Regulatory Commission's ("FERC" or "Commission") orders reaffirming its *Policy for Selective Discounting by Natural Gas Pipelines*, when Illinois Municipal Gas Agency ("IMGA"), Northern Municipal Distributors Group and Midwest Region Gas Task Force Association (collectively "Petitioners") have failed to demonstrate that they have sustained any definitive injury flowing from the Commission's reaffirmation of its 16-year-old Policy Statement, and the issues

complained of are not yet ripe for review.

2. Assuming jurisdiction, whether the Commission's decision to retain its current policy that permits pipelines to discount their rates, on a nondiscriminatory basis, in order to meet competition, was reasonable and based on substantial evidence.

STATUTES AND REGULATIONS

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

COUNTERSTATEMENT OF JURISDICTION

As demonstrated in Section I of the Argument below, Petitioners do not have standing to bring their claim before this Court, in that they have not suffered, and are not in imminent peril of suffering, any justiciable injury caused by the Commission's reaffirmation of the challenged Policy Statement. *See infra* Argument, Section I. Likewise, this Court should decline review of the challenged orders because they are not ripe for consideration. Any effect on Petitioners awaits the later filing and adjudication of individual ratemaking proceedings, in which Petitioners will be fully able to litigate all claims in the context of specific facts and arguments.

STATEMENT OF THE CASE

I. NATURE OF THE CASE, COURSE OF PROCEEDINGS AND DISPOSITION BELOW

This appeal concerns the Petitioners' challenges to the Commission's orders in *Policy For Selective Discounting by Natural Gas Pipelines*, 111 FERC ¶ 61,309 ("Reaffirmation Order"), JA 1, *order denying reh'g*, 113 FERC ¶ 61,173 (2005) ("Rehearing Order"), JA 29, which simply reaffirmed the Commission's longstanding policy on selective rate discounting.

In 1989, the Commission announced a policy that, if a natural gas pipeline granted a previous discount in order to meet competition, the pipeline is not required in its next Natural Gas Act ("NGA") Section 4, 15 U.S.C. § 717c, rate case to design its rates based on the assumption that those discounted volumes will flow at the maximum rate. *Interstate Natural Gas Pipeline Rate Design*, 47 FERC ¶ 61,295 at 62,056-57, *order on reh'g*, 48 FERC ¶ 61,122 (1989) ("1989 Rate Design Policy Statement" or "Policy Statement"). Rather, the pipeline may propose to reduce the discounted volumes so that it will be able to recover its cost of service. *Id.*

On November 22, 2004, the Commission issued a Notice of Inquiry seeking comments on: (1) whether the 1989 Rate Design Policy Statement should continue to be applied to discounts provided to meet competition from another natural gas

pipeline;[1] and (2) the 1989 Rate Design Policy Statement's impact on captive customers. *Policy for Selective Discounting By Natural Gas Pipelines*, 109 FERC ¶ 61,202 (2004), R. 1, JA 77. After considering the comments filed by 40 parties, the Commission reaffirmed the existing discount policy, finding it to be "an integral and essential part of the Commission's policies furthering the goal of developing a competitive national natural gas transportation market" that "provides for safeguards to protect captive customers." Reaffirmation Order at P 2, JA 1. Moreover, the Reaffirmation Order explained that "in today's dynamic natural gas market, any effort to discourage pipelines from offering discounts to meet gas-on-gas competition would do more harm than good." *Id.* at P 18, JA 7.

II. STATEMENT OF FACTS

A. Statutory and Regulatory Framework

Section 4 of the NGA requires the Commission to ensure that rates of FERC-jurisdictional interstate natural gas pipelines are "just and reasonable." 15 U.S.C. § 717c(a).

FERC Order No. 436 commenced the transition to open access transportation. Pursuant to that order, the Commission adopted regulations

[1] Competition for business between two or more natural gas pipelines, as opposed to competition between providers of natural gas and providers of other fuels, is referred to as "gas-on-gas competition."

requiring pipelines to file maximum and minimum transportation rates for both firm and interruptible service and to charge rates to customers within the maximum and minimum range. *See Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, FERC Stats. & Regs., Regulations Preambles (1982-1985) ¶ 30,665 at 31,540-45 (1985). In addition, the regulations permitted a pipeline to engage in selective discounting based on the varying demand elasticities of the pipeline's customers. *Id.* at 31,544; *see also* 18 C.F.R. § 284.10. Thus, pipelines became eligible to discount, on a nondiscriminatory basis, to meet competition. Order No. 436 at 31,546. The Commission explained that these selective discounts would benefit all customers, including customers that did not receive the discounts, by allowing a pipeline to maximize throughput and, thus, spread its fixed costs across more units of service. *Id.* at 31,545; *see also* 18 C.F.R. § 284.10. Selective discounting would also protect captive customers from rate increases that would have otherwise occurred if a pipeline lost volumes because it was unable to respond to competition. Order No. 436 at 31,545. In *Associated Gas Distributors v. FERC*, 824 F.2d 981, 1011-12 (D.C. Cir. 1987), this Court upheld the regulations permitting selective discounting adopted in Order No. 436.

In the 1989 Rate Design Policy Statement, the Commission sought to adopt a rate design methodology that would prevent the subsidization of discounts by non-discounted customers, while simultaneously achieving Order No. 436's goal

of maximizing throughput. Under the 1989 Policy Statement, where a pipeline grants a discount to meet competition, the pipeline would be relieved of the requirement to design rates, in its next rate case, based on the assumption that the discounted volumes will flow at the maximum rates; instead, the pipeline may reduce the discounted volumes so as to recover its cost of service. *Interstate Natural Gas Pipeline Rate Design*, 47 FERC ¶ 61,295, *reh'g granted*, 48 FERC ¶ 61,122 (1989). That ruling was based on a concern that requiring rates to reflect discounted service being priced at the maximum rate in a subsequent rate case could act as a disincentive to future discounting to capture marginal firm and interruptible business. *Id.* at 62,056. This is because:

> Standard FERC ratemaking, in its most simple form, involves projecting a "revenue requirement" for service on the pipeline's facilities and dividing the sum by projected "throughput." The quotient is a maximum unit rate. Although both the revenue requirement and throughput are largely based on past experience, both figures are projections. Where it is expected that some service will be sold at a discount from the maximum rate, there is obviously a problem with assuming that throughput – itself enhanced by discounts – will, when multiplied by the maximum rate, yield the revenue requirement.

Interstate Natural Gas Ass'n of Am. v. FERC, 285 F.3d 18, 56 (D.C. Cir. 2002).

To further increase opportunities for competition, FERC also instituted "capacity release" in Order No. 636, which created competition between a pipeline and its shippers with respect to unused capacity. *See Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, 59 FERC ¶ 61,030 (1992).

Competition from capacity release further induced pipelines to discount their interruptible and short-term firm capacity. *See* Order No. 636-B, *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol,* 61 FERC ¶ 61,272 at 61,999 (1992).

B. Events Leading to the Orders on Review

Since the 1989 Rate Design Policy Statement, various parties, including Petitioners, have challenged the assumptions underlying discounting with regard to the issue of gas-on-gas competition.[2] Specifically, they contend that the benefits to captive customers of allowing fixed costs to be spread over more units of service are illusory when discounts are for gas-on-gas competition. "IMGA and kindred opponents" of the Commission's discounting policy charge that "the demand for pipeline service is largely inelastic *in the aggregate*; as a result the rate discounts do not produce an overall increase in throughput but merely shift it around among pipelines." *Interstate Natural Gas Ass'n*, 285 F.3d at 57 (emphasis in original). Based on that premise, they assert that "the competitive customers [who receive a discount] enjoy a decrease in rates and, the captives, instead of enjoying the

[2] For example, in *Southern Natural Gas Co.*, 67 FERC ¶ 61,155 (1994), it was argued that no discount adjustment should be permitted with respect to gas-on-gas competition. The Commission rejected that argument, concluding that "in light of the dynamic nature of the natural gas market . . . any effort to prohibit interstate gas pipelines from discounting to meet gas-on-gas competition would inevitably result in a loss of throughput to the detriment of all their customers." *Id.* at 61,458.

supposed benefit, actually experience higher rates as the aggregate contribution of the competitive customers is reduced." *Id.* *See also* Pet. Br. at 7-9.

On July 2, 1997, IMGA filed its Rulemaking Petition, R. 11a, JA 216-31, which requested the Commission "(1) to convene a rulemaking to determine the proper ratemaking treatment of discounts given to customers of interstate natural gas pipeline transmission companies for gas-on-gas competitive reasons (including capacity release volumes); and (2) . . . [to] establish a rule of general applicability that pipelines' maximum rates be based on estimates of the pipelines' total throughput without regard to discounts given for gas-on-gas competition with other jurisdictional pipelines." *Id.* at 15, JA 231. The Rulemaking Petition was docketed as FERC Docket No. RM97-7-000.

Then, IMGA claimed inaction on the part of the Commission and filed a petition for writ of mandamus with this Court in Case No. 98-1347 on July 24, 1998, seeking an order that the Commission proceed on the Rulemaking Petition. *See* Pet. Br. at 11-12. The Court denied without prejudice IMGA's petition because IMGA had not shown that FERC's delay was so egregious or unreasonable as to warrant the extraordinary remedy of mandamus. *See In re Illinois Mun. Gas Agency*, No. 98-1347, 1998 U.S. App. LEXIS 30938 (D.C. Cir. Nov. 24, 1998) (unpublished disposition).

The issue of discounts for gas-on-gas competition was also raised in

Interstate Natural Gas Ass'n. This Court denied IMGA's petition for review, leaving the matter for Commission resolution in a rulemaking. *See* 285 F.3d at 58.

On August 31, 2004, IMGA filed a second mandamus petition with this Court, seeking an order that the Commission act on its Rulemaking Petition. While this mandamus petition was pending, the Commission acted on the Rulemaking Petition and this Court dismissed the second mandamus petition as moot. *See In re Illinois Mun. Gas Agency*, No. 04-1298, 2005 U.S. App. LEXIS 25266 (D.C. Cir. Mar. 21, 2005) (unpublished disposition).

Specifically, on November 22, 2004, the Commission issued a Notice of Inquiry in Docket No. RM05-2-000, which sought "comments on its policy regarding selective discounting by natural gas pipeline companies." *See* 109 FERC ¶ 61,202 at P 1 (2004), R. 1, JA 77; *see also id.* at P 15, JA 83 ("In particular, the Commission is interested in exploring the effects of the policy of permitting a discount adjustment in a rate case for all selective discounts, including those given to meet gas-on-gas competition . . . ."). Among other rate issues addressed, the Commission requested comments as to "whether the Commission's practice of permitting pipelines to adjust their ratemaking throughput downward in rate cases to reflect discounts given by pipelines for competitive reasons is appropriate when the discount is given to meet competition from another natural gas pipeline." *Id.* at P 1, JA 77. It further asked "what alternative changes in the

Commission's discount adjustment policy could be considered to minimize any adverse effects on captive customers." *Id.* at P 15(3), JA 86.

As the Notice of Inquiry was given its own docket number (RM05-2-000), the Commission decided that it would "consider all the comments in Docket No. RM05-2-000 and w[ould] terminate the proceeding in Docket No. RM97-7-000 [instituted by IMGA's Rulemaking Petition] because the issues included in Docket No. RM05-2-000 include all the issues raised in the Docket No. RM97-7-000 proceeding." *Id.* at P 16, JA 87. IMGA did not seek rehearing of the Commission's decision to terminate the Docket No. RM97-7-000 rulemaking proceeding and did not, either in its subsequent comments or in its rehearing request, object to the procedural forum offered to it in Docket No. RM05-2-000. Reaffirmation Order at P 6 & n.5, JA 3; Rehearing Order at P 5 & n.7, JA 30-31; IMGA Request for Rehearing, R. 52 & 53, JA 361-89 & 390-92.

C. The Orders Under Review

After receiving comments and responses from 40 parties, including the Petitioners, the Commission issued the Reaffirmation Order on May 31, 2005. That order addressed all of the issues raised in the 2004 Notice of Inquiry, which subsumed the issues raised in IMGA's 1997 Rulemaking Petition, and, having addressed them, terminated the rulemaking proceeding. The Commission reaffirmed "its current policy on selective discounting" as being "an integral and

essential part of the Commission's policies furthering the goal of developing a competitive national natural gas transportation market." Reaffirmation Order at P 2, JA 1. The Reaffirmation Order held that the Commission would "not modify its current policies concerning selective discounting" and would "continue to allow a pipeline to seek a reduction in the volumes used to design its maximum rates, if it obtained those volumes by offering discounts to meet competition, regardless of the source of that competition." *Id.* at P 14, JA 5-6. Moreover, the Reaffirmation Order explained that "in today's dynamic natural gas market, any effort to discourage pipelines from offering discounts to meet gas-on-gas competition would do more harm than good." *Id.* at P 18, JA 7.

In the Rehearing Order, the Commission denied the Petitioners' requests for rehearing, explaining, in part:

> While the permission given by the Commission to pipelines to discount their rates between a minimum and maximum rate was promulgated in Order No. 436 and adopted in a regulation,[[3]] the adjustment in throughput to recognize discounting is not a rule, but is a policy that was adopted by the Commission in the [1989] Rate Design Policy Statement. Therefore, in individual rate cases, the parties are free to develop a record based on the specific circumstances on the pipeline to determine whether the discounts given were beneficial to captive customers. The pipeline has the burden of proof under section 4 of the NGA in a rate case to show that its proposal is just and reasonable. If there are circumstances on a particular pipeline that may warrant special considerations or

[3] Citing 18 C.F.R. § 284.10.

> disallowance of a full discount adjustment, those issues may be addressed in individual proceedings.[[4]] Parties in a rate proceeding may address not only the issue of whether a discount was given to meet competition, but also issues concerning whether the discount was a result of destructive competition and whether something less than a full discount adjustment may be appropriate in the circumstances.

Rehearing Order at P 22, JA 35 (second footnote containing citation omitted).

These petitions for review followed.

SUMMARY OF ARGUMENT

Petitioners do not have standing to bring their claims before this Court. They have failed to demonstrate that they have suffered, or are in imminent peril of suffering, any injury due to the Commission's reaffirmation of its 16-year old Policy Statement, and the issues complained of are not ripe for review in this proceeding. In the challenged orders, Commission merely reaffirmed the existing discount policy, finding it to be "an integral and essential part of the Commission's policies furthering the goal of developing a competitive national natural gas transportation market" that "provides for safeguards to protect captive customers." Reaffirmation Order at P 2.

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

However, contrary to Petitioners' contentions, the orders on review involve no application of the stated policy to any pipeline and thus have no immediate and significant impact on Petitioners, nor are the issues and record suitable for judicial review. Rather, implementation of the policy is left entirely to later individual pipeline rate proceedings and there is no record on which to evaluate any potential injury to Petitioners.

Assuming jurisdiction, based on substantial evidence in the record, the Commission reasonably exercised its broad discretion in retaining its current policy that permits pipelines to discount their rates, on a nondiscriminatory basis, in order to meet competition. The Commission's orders applied the correct legal criteria based on the facts.

Specifically, the Petitioners' claims were sufficiently weighed and rejected based on the Commission's analysis of the benefits the policy provided versus the harm that its elimination would create, and the Commission appropriately decided that case-by-case adjudication was the correct approach. Moreover, the Commission's rejection of a proscription of discounting in the context of capacity release was reasonable based on the Commission's goals of creating robust secondary markets. Finally, the orders were well-reasoned and supported regarding the allocation of the burden of proof, information posting requirements and the need (or lack thereof) for mandatory periodic rate cases.

ARGUMENT

I. THE PETITIONS FOR REVIEW SHOULD BE DISMISSED FOR LACK OF JURISDICTION BECAUSE PETITIONERS LACK STANDING AND THE ISSUES COMPLAINED OF ARE NOT RIPE FOR JUDICIAL REVIEW

It is undisputed that the orders on review involved no application of the discount allowance policy to any pipeline; rather, they merely reaffirmed the existing policy, finding it to be "an integral and essential part of the Commission's policies furthering the goal of developing a competitive national natural gas transportation market" that "provides for safeguards to protect captive customers." Reaffirmation Order at P 2, JA 1.

However, implementation and application of the policy is left entirely to later individual pipeline rate proceedings, and there is no record on which to evaluate any potential injury to Petitioners. *See, e.g.,* Reaffirmation Order at PP 2, 18, 42, 57, 62, 77, JA 1, 7, 19-20, 21, 24; Rehearing Order at PP 22, 32-33, 37-38, 53, 55-60, 62, 89, JA 35, 40, 41, 42-43, 48, 49-51, 52, 61. The orders simply "will continue to allow a pipeline to seek a reduction in the volumes used to design its maximum rates, if it obtained those volumes by offering discounts to meet competition, regardless of the source of that competition." Reaffirmation Order at P 14, JA 5-6; *see also* Rehearing Order at PP 21-22, 24, 37, 107, JA 35, 36, 42, 67-68.

The discounting policy is thus permissive but not automatic; *i.e.,* while a

pipeline may *seek* the discount adjustment in its next rate case, the Commission has made no guarantee that ultimately it will grant any specific adjustment in any particular case. In fact, the Commission specifically warned that "[a] discount adjustment is not an entitlement and the pipelines would be ill-advised to consider it so." Rehearing Order at P 24, JA 36.

Indeed, Petitioners acknowledge (Pet. Br. at 22) that the effect of the orders "is that pipelines will continue to be permitted to seek to adjust their throughput volumes in rate cases for discounts previously given to meet gas-on-gas competition, as they have been able to do for the past 16 years." Thus, the orders on review determine no pipeline's *entitlement* to a discount adjustment, and thus Petitioners are not injured by the orders nor do they face the threat of imminent injury.

Similarly, the orders on review are not ripe for review as they create no new policy. They merely reaffirmed the Commission's longstanding discounting policy (a policy of general applicability, *see* Rehearing Order at PP 31, 37, 72, JA 40, 42, 56) and denied the Petitioners' request that the Commission modify that policy to prohibit pipelines from later seeking adjustments to their rate design volumes to account for discounts given to meet gas-on-gas competition. *See, e.g.,* Reaffirmation Order at P 18, JA 7; Rehearing Order at PP 7, 31, 48, JA 31, 40,

46-47.[5]

A. Petitioners Lack Standing To Challenge The Orders On Review

Under NGA § 19(b), 15 U.S.C. § 717r(b), only a party that is "aggrieved" by a Commission order may obtain judicial review. *See, e.g., Interstate Natural Gas Ass'n*, 285 F.3d at 45 (a petitioner is "aggrieved" within the meaning of NGA § 19(b) if as a result of a Commission order, the petitioner "has sustained 'injury in fact' to an interest arguably within the zone of interests to be protected or regulated by the [Commission] under the Act").

An "aggrieved" petitioner must meet the constitutional standing requirements. *See, e.g., Louisiana Energy & Power Auth. v. FERC*, 141 F.3d 364, 366 (D.C. Cir. 1998). These requirements are that: (1) a petitioner must have suffered an "injury in fact" – an "invasion of a legally protected interest which is (a) concrete and particularized . . . and (b) actual or imminent, not conjectural or hypothetical," (2) there must be a "causal connection between the injury and the conduct complained of," and (3) "it must be likely, as opposed to merely

[5] On February 28, 2006, the Commission filed a motion to dismiss the instant appeals for lack of jurisdiction. Petitioners Northern Municipal Distributors Group and the Midwest Region Gas Task Force Association filed their response opposing the motion to dismiss on March 8, 2006. IMGA filed its motion to strike and response opposing the motion to dismiss on March 20, 2006. This Court issued an order on June 16, 2006, denying the motion to strike and referring the motion to dismiss to the merits panel to which the petitions for review are assigned, and directing parties "to address in their briefs the issues presented in the motion to dismiss rather than incorporate those arguments by reference."

speculative, that the injury will be redressed by a favorable decision." *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560-561 (1992) (citations and internal quotation marks omitted); *see also, e.g., Bennett v. Spear*, 520 U.S. 154, 162 (1997).

Here, the orders simply preserve a policy of general applicability, but grant no actual discount adjustment to any pipeline. The policy is permissive, but not automatic. A pipeline may seek a discount adjustment in a specific future rate case, but the Commission does not guarantee that that it will be granted. *See, e.g.,* Reaffirmation Order at PP 2, 18, 42, 57, 62, 77, JA 1, 7, 19-20, 21, 24; Rehearing Order at PP 22, 32-33, 37-38, 53, 55-60, 62, 89, JA 35, 40, 41, 42-43, 48, 49-51, 52, 61. Therefore the claimed harm arising from future rate proceedings is merely speculative. Under these circumstances, Petitioners have not suffered an injury, concrete or otherwise, that is in any way actual or imminent. *See Village of Bensenville v. FAA*, 376 F.3d 1114, 1118 (D.C. Cir. 2004) (quoting both *Rainbow/PUSH Coal. v. FCC*, 330 F.3d 539, 542 (D.C. Cir. 2003), and *Sierra Club v. EPA*, 292 F.3d 895, 899 (D.C. Cir. 2002)).

B. The Issues Presented By The Petitioners Are Not Ripe For Judicial Review

Even if Petitioners satisfy the Court's requirements for standing, the issues presented are not ripe for judicial review. The ripeness doctrine's "basic rationale is to prevent the courts, through avoidance of premature adjudication, from

entangling themselves in abstract disagreements over administrative policies, and also to protect the agencies from judicial interference until an administrative decision has been formalized and its effects felt in a concrete way by the challenging parties." *Abbott Labs. v. Gardner*, 387 U.S. 136, 148-49 (1967). Accordingly, a challenge to the substance of a policy statement is not typically considered ripe until the policy statement is "reflected in subsequent agency actions." *Hudson v. FAA*, 192 F.3d 1031, 1035 (D.C. Cir. 1999) (citing *Pacific Gas & Elec. Co. v. FPC,* 506 F.2d 33 45, 48-49 (D.C. Cir. 1974) ("*Pacific Gas"*)). The logic of applying the ripeness doctrine is even more apparent where, as here, the Commission did not institute a new policy or rule, but merely declined to dismantle a policy statement that had been in place for sixteen years.

1. The challenged orders did not terminate a request for a rulemaking

Petitioners attempt to evade the lack of ripeness here by contending that the they are aggrieved by the orders on review because those orders "addressed the merits of IMGA's *Rulemaking Petition* and the comments of other parties in support of that petition, rejected them and terminated the rulemaking proceeding. . . . The termination and rejection of a rulemaking petition is aggrievement and is ripe for judicial review. *Hadson Gas Systems, Inc. v. FERC*, 75 F.3d 680, 684 (D.C. Cir. 1996)." Pet. Br. at 19-20 (internal references omitted).

However, *Hadson Gas Systems* is inapposite. While an agency's decision

not to open a rulemaking may be judicially reviewable under the "deferential arbitrary and capricious standard," 75 F.3d at 684, the Commission never denied the opening of a rulemaking proceeding in this case. To the contrary, the rulemaking was undertaken and expanded, to include discounting issues beyond those initially raised by IMGA. As previously discussed, the Commission decided that it would "consider all the comments in Docket No. RM05-2-000 and w[ould] terminate the proceeding in Docket No. RM97-7-000 [instituted by IMGA's Rulemaking Petition] because the issues included in Docket No. RM05-2-000 include all the issues raised in the Docket No. RM97-7-000 proceeding." *See* Notice of Inquiry at P 16, R. 1, JA 87; *see also id.* at P 15, JA 83-87 (inviting comments on the policy regarding 22 separate issues and sub-issues).

IMGA never sought rehearing of the Commission's decision to terminate the Docket No. RM97-7-000 proceeding it initiated and did not, either in its subsequent comments or in its rehearing request, object to the procedural forum offered to it in Docket No. RM05-2-000. Reaffirmation Order at P 6 & n.5, JA 3; Rehearing Order at P 5 & n. 7, JA 30-31; IMGA Request for Rehearing, R. 52 & 53, JA 361-89 & 390-92. Thus, the only thing the Commission "terminated" was a particular Commission docket number; the Commission never "terminated" the review of the underlying issues raised by Petitioners. Rather, the Commission expanded that review and ultimately issued a decision, based on substantial

evidence in the record and its reasonable discretion, that reaffirmed the soundness of the Commission's longstanding discounting policy statement.

Even assuming, *arguendo*, that the Commission's orders could be considered as a refusal to undertake a rulemaking, here the Commission merely upheld its prior policy on selective discounting and left specific challenges to case-by-case determinations in the future. Such an approach is entitled to deference. *See Arkansas Power & Light Co. v. ICC,* 725 F.2d 716, 723 (D.C. Cir. 1984) ("It is well-established that the choice between rulemaking and case-by-case adjudication 'lies primarily in the informed discretion of the administrative agency'" citing *NLRB v. Bell Aerospace Co.,* 416 U.S. 267, 293 (1974) (quoting *SEC v. Chenery Corp*., 332 U.S. 194, 203 (1947)).

2. The challenged orders do not a create a "binding norm" and thus pose no "looming unavoidable threat"

Next, the Petitioners claim standing because under the Commission orders:

> pipelines will continue to be permitted to seek to adjust their throughput volumes in rate cases for discounts previously given to meet gas-on-gas competition, as they have been able to do for the past 16 years. Petitioners are faced with a "looming unavoidable threat," because FERC has denied their requests that the Commission abandon or significantly modify the Discounted Throughput Adjustment Policy.

Pet. Br. at 22.

However, with respect to the Commission's selective discounting policy, the Northern Municipal Distributors Group and the Midwest Region Gas Task Force

Association (two of the three Petitioners in this case), in a related case, recently acknowledged:

"A policy statement does not establish a 'binding norm'":

> [i]t is not finally determinative of the issues or rights to which it is addressed. The agency cannot apply or rely upon a general statement of policy as law because a general statement of policy only announces the agency's tentative intentions for the future. When the agency applies the policy in a particular situation, it must be prepared to support the policy just as if the policy statement had never been issued. An agency cannot escape its responsibility to present evidence and reasoning supporting its substantive rules by announcing binding precedent in the form of a general policy statement.

Brief of Petitioners at 28-29, *Midwest Region Gas Task Force Association v. FERC,* Nos. No. 05-1468 *et al.* (D.C. Cir. Nov. 17, 2006) (citing *Pacific Gas*, 506 F.2d at 38). Thus, a policy statement that does not constitute a "binding norm" can hardly constitute a "looming unavoidable threat."

As this Court (and two of the three Petitioners in this case) has recognized, a policy differs from a substantive rule in that the policy statement is not finally determinative of the issues or rights to which it is addressed; when the agency applies the policy in a particular situation, it must be prepared to support the policy just as if the policy statement had never been issued. *Pacific Gas*, 506 F.2d at 38. *See, e.g., New York State Elec. & Gas Corp. v. FERC*, 177 F.3d 1037, 1041 (D.C. Cir. 1999) (where orders indicated Commission intended to apply in pipeline's

next rate case presumption in favor of rolled-in rates from pricing policy statement, petitioner's challenge to those orders was not ripe because petitioner could challenge Pricing Policy Statement presumption, as well as the pipeline's rates, in the subsequent rate proceeding if rolled-in rates were actually approved).

As previously noted, the Commission's reaffirmance of its policy did not grant a discount adjustment to any pipeline. The policy is permissive, but not automatic. A pipeline may seek a discount adjustment in a specific future rate case, but the Commission does not guarantee that that it will be granted. *See, e.g.,* Reaffirmation Order at PP 2, 18, 42, 57, 62, 77, JA 1, 7, 19-20, 21, 24; Rehearing Order at PP 22, 32-33, 37-38, 53, 55-60, 62, 89, JA 35, 40, 41, 42-43, 48, 49-51, 52, 61.

Under the Commission's policy, "the pipeline may propose as part of a [NGA] section 4 rate filing to adjust its rate design volumes to account for any discounts it gave during the test period, including discounts given in competition with other pipelines. By proceeding on this basis, the Commission must find, based on the record developed in each rate case, that the pipeline has met its section 4 burden to show that any approved discount adjustment to rate design volumes is just and reasonable." Rehearing Order at P 37, JA 42. As the orders reaffirming the policy statement involved no application of the stated policy to any pipeline, they have no immediate and significant impact on Petitioners, nor are the

issues and record suitable for judicial review. *Pacific Gas*, 506 F.2d at 48 (citing *Abbott Labs.*, 387 U.S. 136, and *Toilet Goods Ass'n, Inc. v. Gardner*, 387 U.S. 158 (1967)).

Moreover, "[w]hen the agency states that in subsequent proceedings it will thoroughly consider not only the policy's applicability to the facts of a given case but also the underlying validity of the policy itself, then the agency intends to treat the order as a general statement of policy." *Pacific Gas*, 506 F.3d at 39. Here, the Commission specifically recognized:

> If there are circumstances on a particular pipeline that may warrant special considerations or disallowance of a full discount adjustment, those issues may be addressed in individual proceedings. Parties in a rate proceeding may address not only the issue of whether a discount was given to meet competition, but also issues concerning whether the discount was a result of destructive competition and whether something less than a full discount adjustment may be appropriate in the circumstances.

Rehearing Order at P 22, JA 35.

> In addition, as the Commission stated in the [Reaffirmation Order] and discusses further below, the Commission will consider the impact of any discount adjustment on captive customers in specific proceedings. The Commission's termination of the instant rulemaking proceeding is a decision to continue to address the discount adjustment issue in the same case-by-case manner. Thus, the [Reaffirmation Order] should not be interpreted as establishing any definitive rule that pipelines will in all instances be permitted a full discount adjustment for discounts given in competition with another pipeline. Rather, the Commission simply determined in the [Reaffirmation Order] to reject the rehearing applicants' proposal to establish a definitive rule prohibiting pipelines from proposing in section 4 rate cases discount adjustments with respect to discounts

given in competition with other pipelines.

Id. at P 37, JA 42.

3. The Commission has previously permitted, and here has invited, future challenges to particular discounts in individual rate proceedings

Petitioner contends that "what had started out as the Policy Statement's rejection of a 'prophylactic rule' against all adjustments for discounts, had now transformed itself into an irrebuttable rule requiring adjustments for discounts." Pet. Br. at 8. This statement simply ignores the record. The Commission has made it abundantly clear that "[a] discount adjustment is not an entitlement and the pipelines would be ill-advised to consider it so." Rehearing Order at P 24, JA 36. The Commission also cited several specific cases where the pipelines were denied the adjustments they sought in individual rate cases:

> The Commission does not routinely grant pipelines a discount adjustment, but grants such an adjustment only to the extent that the discount was required to meet competition. The Commission has denied pipelines the adjustment where the pipeline has failed to meet its burden of showing that the discount was required to meet competition. For example, in *Panhandle Eastern Pipe Line Co*,[[6]] *Williams Natural Gas Co,*[[7]] and *Trunkline Gas Co.,*[[8]] the Commission held that the pipeline had not met its burden to show that its discounts to its affiliates were required by competition. In

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[6] 74 FERC ¶ 61,109 at 61,401-02 (1996).

[7] 77 FERC ¶ 61,277 at 62,206-07 (1996).

[8] 90 FERC ¶ 61,017 at 61,096 (2000).

> addition, in *Iroquois Gas Transmission System*[[9]] and *Trunkline Gas Co.,*[[10]] the Commission disallowed a discount adjustment with respect to discounts given to non-affiliates. In both cases, the discounts were given to long-term, firm customers.

Rehearing Order at P 24, JA 36 ; *see also* Reaffirmation Order at PP 18 & n.11, 57, 66, JA 7, 19-20, 22; Rehearing Order at PP 55, 57-59, 62, 104, JA 49, 50-51, 52, 66.

Looking toward the future, the Commission repeatedly invited specific challenges to proposed adjustments in specific rate cases. *See* Reaffirmation Order at PP 2, 18, 42, 57, 62, 77, JA 1, 7, 19-20, 21, 24; Rehearing Order at PP 22, 32-33, 37-38, 53, 55-60, 62, 89, JA 35, 40, 41, 42-43, 48, 49-51, 52, 61.

In particular, the Commission recognized that, while in most instances this policy promotes competitive benefits for the majority of shippers, certain captive customers in certain circumstances might require special consideration and protection where the Commission's policy works an undue hardship on them, and that this protection could be addressed in individual rate cases. *See* Reaffirmation Order at PP 52-57, JA 18-20; Rehearing Order at PP 22, 32-33, 37-38, 53, 59, 62, 90-91, 109-116, JA 35, 40-41, 42-43, 48, 50-51, 52, 61-62, 68-71.

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[9] 84 FERC ¶ 61,086 at 61,476-78 (1998).

[10] 90 FERC ¶ 61,017 at 61,092-95 (2000).

Thus, Petitioners' concerns can be explored fully in specific pipeline rate cases. Until then, their claims are not ripe for review.

4. Denying review here will not prejudice Petitioners

This court has recognized that "[s]ettled principles of ripeness require that [a court] postpone review of administrative decisions where (1) delay would permit better review of the issues while (2) causing no significant hardship to the parties." *United Distrib. Cos. v. FERC*, 88 F.3d 1105, 1182 (D.C. Cir. 1996) (quoting *Northern Indiana Pub. Serv. Co. v. FERC*, 954 F.2d 736, 738 (D.C. Cir. 1992)). These principles apply where, as here, Petitioners have suffered no injury from the mere continuation of the Commission's 16-year old policy on rate discounting, and that policy will be fully reviewable upon its application in an individual pipeline proceeding. *See, e.g., Northern Indiana*, 954 F.2d at 737 (claim not ripe where challenged orders approved only concept and outline of open-access transmission without authorizing specific transactions, and petitioner would have opportunity to challenge open access at the time specific transactions are approved).

Finally, if a discount adjustment is proposed by a pipeline in some future rate case and Petitioners would suffer some injury from the agency's action on that proposal, they will then have the opportunity to pursue their arguments and full redress on appeal. *See Toca Producers v. FERC*, 411 F.3d 262, 266 (D.C. Cir. 2005); *Friends of Keeseville v. FERC*, 859 F.2d 230, 236-37 (D.C. Cir. 1988).

II. STANDARD OF REVIEW

The Court reviews FERC orders under the arbitrary and capricious standard of 5 U.S.C. § 706(c)(A). *Florida Mun. Power Agency v. FERC*, 315 F.3d 362, 365 (D.C. Cir. 2003). Under that standard, the Commission's decision must be reasoned and based upon substantial evidence in the record. The Commission's factual findings are conclusive if supported by substantial evidence. NGA § 19(b), 15 U.S.C. § 717r(b). The substantial evidence standard "'requires more than a scintilla, but can be satisfied by something less than a preponderance of the evidence.'" *Florida Mun.*, 315 F.3d at 365 (quoting *FPL Energy Maine Hydro LLC v. FERC*, 287 F.3d 1151, 1160 (D.C. Cir. 2002)).

Furthermore, the Commission's "determinations regarding rates of return, definition of rate base, and other technical aspects of ratemaking" are entitled to considerable weight. *Public Serv. Comm'n v. FERC*, 813 F.2d 448, 451 (D.C. Cir. 1987). The Commission's reaffirmation of its Policy Statement on rate discounting was reasonable, responsive to the arguments of the various parties, and supported by substantial evidence in the record.

III. THE COMMISSION REASONABLY RETAINED THE POLICY STATEMENT BASED ON SUBSTANTIAL EVIDENCE

Assuming jurisdiction, Petitioners argue that the Commission's orders violate statutory and court imposed standards. Pet. Br. at 22-29. They also argue that the Commission's findings of fact are arbitrary and capricious and not

supported by substantial evidence. *Id.* at 29-34. They dismiss the utility of pursuing the discount adjustment issue in future adjudications. *Id.* at 34-41. They argue that the Commission erred in finding that pipelines are permitted to seek a discount adjustment for discounts resulting from competition with capacity release. *Id.* at 41-50. Finally, the Petitioners argue that the policy is arbitrary and capricious in three specific respects: (1) the Commission misapplied the burden of proof, *id.* at 51-54; (2) the Commission's information posting requirements are not sufficiently stringent, *id.* at 54-56; and, (3) the Commission should have required that pipelines file periodic rate cases. *Id.* at 56-61. These contentions are without merit.

A. The Commission Applied the Proper Legal Criteria

The core of Petitioners' attack on the Commission's orders is their contention that the discount adjustment to throughput can only be permitted if it can be shown to produce a net benefit to captive customers and that it was error for the Commission to reject this premise. Pet. Br. at 22-23. Further, they contend that the Commission's balancing of interests ignored cases cited by the Petitioners. *Id.* Finally, Petitioners argue that the Commission's orders violate the prohibition against undue discrimination of sections 4 and 5 of the NGA, 15 U.S.C. §§ 717c-d. *Id.* at 24.

However, as explained in the orders under review, the Commission applied

the proper legal standards to its evaluation of the policy statement and complied with its statutory responsibilities:

> In the [Reaffirmation Order], the Commission discussed its responsibilities under the NGA and cited to Order No. 636:
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> > The Commission's responsibility under the NGA is to protect the consumers of natural gas from the exercise of monopoly power by the pipelines in order to ensure consumers 'access to an adequate supply of gas at a reasonable price.' [*Tejas Power Corp. v. FERC*, 908 F.2d 998, 1003 (D.C. Cir. 1990).] This mission must be undertaken by balancing the interests of the investors in the pipeline, to be compensated for the risks they have assumed, and the interests of consumers, and in light of current economic, regulatory, and market realities [citing Order No. 636 at 30,392].
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> The Commission then concluded that, in light of existing conditions in the natural gas market, its existing policies concerning selective discounting are more consistent with the goal of ensuring adequate supplies at a reasonable price, than any of the alternatives proposed in the comments in response to the [Notice of Inquiry].

Rehearing Order at P 28, JA 38-39 (citing Reaffirmation Order at P 14, JA 5-6); *see also Edison Mission Energy, Inc. v. FERC,* 394 F.3d 964, 969 (D.C. Cir. 2005) (relevant question is whether the Commission's ratemaking policy "will do more good than harm") (quoting *Maryland People's Counsel v. FERC*, 761 F.2d 780, 788-89 (D.C. Cir. 1985)).

The Commission fully demonstrated that it understood its responsibilities under the NGA, in that it must, in all of its decisions, balance a number of

interests, as was done in this case. *See* Reaffirmation Order at P 14, JA 5-6; Rehearing Order at PP 30-31, JA 39-40. While the Commission has an obligation to protect captive customers, as it did here, the Commission also has broad responsibilities to develop policies of general applicability. In that context, the Commission reasonably found, after having analyzed the concerns of the Petitioners in the context of the overall benefits to the national pipeline system provided by the selective discount policy (including allowing a discount adjustment for gas-on-gas competition), continuation of that policy generally benefits all customers, including customers who do not receive the discount. Rehearing Order at P 31, JA 40; *see also* Reaffirmation Order at PP 15-37, 63; JA 6-14, 21; Rehearing Order at PP 7-15, 35-60, JA 31-33, 41-51.

After a thorough examination of all the facts, the Commission properly concluded that the Petitioners' view of the Commission's responsibilities was too narrow, because, by their contention, if there could be a circumstance where a discount does not benefit captive customers then the entire policy must be abandoned. Rehearing Order at P 32, JA 40. While the Commission concluded that the selective discounting policy generally benefits all customers, it has also recognized that there may be circumstances on some pipelines, identified in pipeline-specific rate proceedings, where captive customers may require additional protections. *Id.* It was not necessary, however, for the Commission to eliminate

entirely the discount adjustment for gas-on-gas competition in order to address those limited situations, and the cases cited by Petitioners are not to the contrary. *Id.*

The Commission's decision here meets both goals of promoting a competitive natural gas market and protecting captive customers. The Commission demonstrated that it was possible to adopt measures to protect small publicly-owned municipal gas companies in circumstances where the policy may work an undue hardship on them (*see* Reaffirmation Order at PP 52-57, JA 18-20) while simultaneously retaining the competitive benefits of the policy for the majority of shippers; thus, the Commission properly balanced all the interests under the proper legal standard. Rehearing Order at P 33, JA 41. This is the type of balancing decision that the courts have recognized is within the Commission's discretion in developing its policies in a competitive marketplace. *See, e.g., Midcoast Interstate Transmission, Inc. v. FERC,* 198 F.3d 960, 970 (D.C. Cir. 2000) (Commission found to have exercised the kind of judgment on matters of policy that Congress has entrusted to it where FERC pricing policy established a presumption of rolled-in rate treatment to offer greater rate certainty).

Further, the Commission recognized its responsibility to ensure that consumers have access to natural gas at reasonable prices, not to promote policies that increase prices, and there is no basis for concluding that the discount policy

increases the delivered price of natural gas to consumers. Rehearing Order at P 34, JA 41. Finally, selective discounting based on different demand elasticities does not constitute undue discrimination under the NGA. *See e.g., Associated Gas Distribs.,* 824 F.2d at 1011; *United Distrib. Cos. v. FERC*, 88 F.3d at 1142.

B. The Commission's Findings Are Supported By Substantial Evidence

Petitioners next claim that, in making its findings, the Commission only weighed those comments supporting the policy statement and essentially ignored all comments opposing that policy. Pet. Br. at 25. However, the orders on review demonstrate that the Petitioners' claims were weighed and evaluated, along with all of the evidence in the record, and that the Commission reasonably exercised its discretion in rejecting Petitioners' arguments based on substantial evidence.

1. Petitioners' claims were properly considered and rejected

As the Petitioners admit in their brief, the record in this case was a large one, consisting of thousands of pages of comments and evidence filed by over 40 parties. Pet. Br. at 4, 13. While it may be true that the Commission did not ultimately side with the Petitioners, the orders undeniably demonstrate that their arguments were sufficiently considered and properly rejected based on the evidence in the record. *See* Reaffirmation Order at PP 6, 13-37 (including notes to cited record materials), JA 3, 5-14; Rehearing Order at PP 5, 35-66 (including notes to cited record materials); JA 30-31, 41-54.

Specifically, the Commission found:

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

Reaffirmation Order at P 29, JA 11. This ultimate rejection of the Petitioners' claim was based on the Commission's careful consideration of the evidence before it. Of the more than 40 parties filing comments in this case, 25 fully supported the policy because it has worked well, they considered it central to the Commission's pro-competitive policies, and they found that it sent appropriate price signals to the market. *Id.* at P 10, JA 5. Further, they argued that a discount adjustment for gas-on-gas competition is essential to competition in the secondary market. *Id.* They asserted that there are safeguards that adequately protect captive customers. *Id.* Another six parties were generally supportive of the policy statement, seeking modification of certain aspects of the policy. *Id.* at P 11, JA 5. Only six parties (including Petitioners) opposed the policy. *Id.* at P 12, JA 5.

Besides relying on the evidence in the record (*see* record cites and notes *supra*), the Commission properly relied on its own 16-year-long experience with the policy and on economic theory. *See* Rehearing Order at PP 25-27, JA 37-38.

The Commission need not conduct such a fact-specific analysis in order to meet the requirement that its decision be supported by substantial evidence. *See Associated Gas Distribs.,* 824 F.2d at 1008 (citing *Wisconsin Gas Co. v. FERC*, 770 F.2d 1144 (D.C. Cir. 1985) (promulgation of generic rate criteria involves the determination of policy goals and the selection of the means to achieve them, and courts do not insist on empirical data for every proposition on which the selection depends)). Further, this Court noted that "agencies do not need to conduct experiments in order to rely on the prediction that an unsupported stone will fall; nor need they do so for predictions that competition will normally lead to lower prices." *Associated Gas Distribs.,* 824 F.2d at 1008-09. *See also Interstate Natural Gas Ass'n*, 285 F.3d at 55 (Commission upheld where its conclusion seemed largely true by definition and it was a "fair inference" that customers paying less than the maximum rate for service had other choices in the market).

Finally, as the Commission explained:

> In [*Associated Gas Distributors*], the court cited to economic treatises in reaching its decision,[[11]] and courts rely on economic theory in their decisions. For example, the decisions in *Williston Basin v. FERC*,[[12]] *Iroquois Gas Transmission System v. FERC*,[[13]] and *Arco*

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[11] Citing *Associated Gas Distribs.*, 824 F.2d at 1010 (citing various economic treatises).

[12] 358 F.3d 45, 49-50 (D.C. Cir. 2004) (citing economic treatise).

[13] 172 F.3d 84, 89 (D.C. Cir. 1999) (citing economic theory, "We note that classic analysis of non-cost-based discounting by carriers has turned on differences

> *Alaska, Inc. v. FERC,*[[14]] rely on economic theory in reaching their conclusions. Therefore, the Commission rejects the arguments of Northern Municipals and IMGA that the [Reaffirmation Order] is not based on substantial evidence because it relies on economic theory rather than empirical data. To the extent that the Commission's orders on the selective discounting policy rely on economic theory, that is entirely proper, and economic theory may be the basis for the Commission's decision.

Rehearing Order at P 27, JA 38.

Based on this evidence, experience and economic theory, the Commission summarized its findings:

> The [Reaffirmation] Order stated that interstate pipelines face three types of so-called gas-on-gas competition: (1) competition from other interstate pipelines subject to the Commission's NGA jurisdiction, (2) competition from capacity releases by the pipeline's own firm customers, and (3) competition from intrastate pipelines not subject to the Commission's jurisdiction. The [Reaffirmation] Order recognized that a significant portion of pipeline discounts are given to meet competition from other interstate pipelines. Some commenters contended that customers receiving such discounts are not fuel switchable and thus would take the same amount of gas even if required to pay the maximum rate of whichever pipeline they choose to use. The Commission rejected this contention, finding that discounts to non-fuel switchable customers can increase throughput and thus benefit captive customers. The Commission pointed to at least five examples of why this is so.

Rehearing Order at P 8, JA 31-32; *see also* Reaffirmation Order at PP 19-28, JA 7-

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in the price elasticity of demand for the carried product. It pursues the goal of an optimal trade-off between the desirability of maximizing output and the necessity of the utility's recovering all its costs.").

[14] 89 F.3d 878, 883 (D.C. Cir. 1996) (citing the inverse-elasticity rule, an economic theory).

11. This conclusion was based on the following findings:

First, the Commission stated that industrial and other business customers of pipelines typically face considerable competition in their own markets and must keep their costs down in order to prosper. Lower energy costs achieved through obtaining discounted pipeline capacity can help them do more business than they otherwise would, thereby increasing their demand for gas. Reaffirmation Order at P 24, JA 9; Rehearing Order at P 9, JA 32.

Second, discounts may reduce the incentive for existing non-fuel switchable customers to install the necessary equipment to become fuel switchable. In addition, potential new customers, such as companies considering the construction of gas-fired electric generators, may be more likely to build such generators if they obtain discounted capacity on the pipeline. In these situations, a discount may cause the customer to contract for a greater amount of capacity on whichever pipeline they choose than they would have if the pipeline had not offered them a discount. Reaffirmation Order at P 25, JA 10; Rehearing Order at P 10, JA 32.

Third, the Commission stated that a local distribution company's need for interstate pipeline capacity depends upon the demand of its customers for gas, and that demand is elastic, since some of the customers are fuel switchable. Local distribution companies also have non-fuel switchable industrial or business

customers whose gas usage may vary depending upon cost. Reaffirmation Order at P 26, JA 10; Rehearing Order at P 11, JA 32.

Fourth, pipeline discounts may enable natural gas producers to keep marginal wells in operation for a longer period and affect their decisions on whether to explore and drill for gas in certain areas with high production costs. Reaffirmation Order at P 27, JA 10-11; Rehearing Order at P 11, JA 32.

Finally, the Commission pointed out that, on many pipeline systems, the bulk of the pipelines' discounts are given to obtain interruptible shippers. All interruptible shippers may reasonably be considered as demand elastic, regardless of whether they are fuel switchable, since their choice to contract for interruptible service shows that they do not require guaranteed access to natural gas. Reaffirmation Order at P 27, JA 10-11; Rehearing Order at P 13, JA 32.

Thus, based on the substantial evidence in the record, the Commission properly found no basis to conclude (as urged by the Petitioners) that overall interstate pipeline throughput would remain at the same level if the Commission discouraged interstate pipelines from giving discounts in competition with one another. Reaffirmation Order at P 29, JA 11; Rehearing Order at P 14, JA 32-33.

2. Discounting provides other public benefits

Moreover, the Commission found that, apart from the issue of the extent to which such discounts increase overall throughput on interstate pipelines, discounts

arising from competition between interstate pipelines provide other substantial public benefits, which would be lost if the Commission sought to discourage such discounting. Rehearing Order at P 14, JA 32-33; Reaffirmation Order at P 30, JA 11. The Commission pointed out that, as a result of increased competition in the gas commodity and transportation markets, there are now market prices for the gas commodity in the production area and for delivered gas in downstream markets. The difference between these prices (referred to as the "basis differential") shows the market value of transportation service between those two points. Rehearing Order at P 14, JA 32-33; Reaffirmation Order at P 32, JA 12.

As the Commission explained, discounting pipeline capacity to the market value indicated by the basis differentials helps increase market efficiency by providing additional benefits. First, such discounting helps minimize the distorting effect of transportation costs on producer decisions concerning exploration and production. Reaffirmation Order at P 33, JA 12; Rehearing Order at P 14, JA 32-33. Second, if several interstate pipelines serve the same downstream market, discounting can help minimize short-term price spikes in response to increases in demand by making the higher cost pipeline more willing to discount down to the basis differential in order to bring more supplies to the downstream market. Reaffirmation Order at P 34, JA 13; Rehearing Order at P 14, JA 32-33. Third, discounting enables interstate pipelines with higher cost structures to compete with

lower cost pipelines. Reaffirmation Order at P 35, JA 13; Rehearing Order at P 14, JA 32-33. Fourth, discounting helps facilitate discretionary shipments of gas into storage during off-peak periods. Reaffirmation Order at P 36, JA 13; Rehearing Order at P 14, JA 32-33. Finally, selective discounting helps pipelines more accurately assess when new construction is needed. Reaffirmation Order at P 37, JA 14; Rehearing Order at P 14, JA 32-33.

Petitioners' claims were not ignored; rather, they were properly weighed and rejected by the Commission based on the record, the Commission's experience and the proper application of economic theory.

C. Case-by-Case Application of the Policy Is Appropriate

Petitioners next claim that the Commission's decision to allow pursuit of the discount adjustment issue in future rate adjudications is "disingenuous, erroneous and unlawful." Pet. Br. at 34-41. For the reasons stated in the Argument, Section I (jurisdiction), *supra,* the Commission's determination to address the application of the policy statement in future rate proceedings is entirely appropriate and consistent with this Court's precedents respecting standing and ripeness.

However, Petitioners also challenge the Commission's approach because "the issue of discounted throughput adjustments for gas-on-gas discounting is not whether an individual pipeline's throughput is increased by the discount, but rather whether all competing pipelines' throughput is collectively increased." Pet. Br. at

34. For the reasons stated in the Argument, Section III.A. (legal standards), *supra,* the Commission acted within its discretion when it found that the Petitioners' view of the Commission's responsibilities was too narrow, because, by their contention, if there could be circumstances where a discount does not benefit captive customers then the entire policy must be abandoned. *See e.g.,* Rehearing Order at P 32, JA 40.

In their brief, Petitioners themselves state:

> Because the Commission requires an iterative process in calculating the discounted throughput adjustment, the adjustment can only be calculated from the data in the work papers included in the compliance filing. *Williston Basin Interstate Pipeline Company*, 72 FERC ¶ 61,074 at 61,378-61,380 (1995); *Northwest Pipeline Corp*., 71 FERC ¶ 61,253 (1995). For this reason, an actual quantification of the impact of the discounted throughput adjustment could only have been done by the pipelines or by a Commission Staff study.

Pet. Br. at 36. As the Petitioners admit, case-specific work papers are necessary to make the appropriate discount adjustment for any given pipeline; accordingly, the Commission's case-by-case approach is eminently reasonable.

Further, the Commission explained in detail the weakness of Petitioners' underlying claim that that the Commission had not shown that increase demand (produced by selective discounting) will translate into increased overall throughput or revenues on interstate pipelines. *See, e.g.,* Rehearing Order at PP 50-55, JA 47-49. Moreover, the Commission demonstrated that, the cases cited by Petitioners notwithstanding, "[t]here is nothing in the record developed in response to the

[Notice of Inquiry] to suggest that the Commission's general policy of permitting pipelines to propose discount adjustments for gas-on-gas competition has led to a widespread cost shift to captive customers" and that "[n]o party was able to point to any rate case where discounts due to gas-on-gas competition actually caused a substantial cost shift to captive customers." *Id.* at P 56, JA 49.

As to the cases cited by Petitioners, the Commission reasonably distinguished them based on the facts and record and established that these cases actually support the case-by-case approach adopted by the Commission. *Id.* at PP 56-60, JA 49-51. For instance, Petitioners pointed to *Natural Gas Pipeline Co. of Am.,* 73 FERC ¶ 61,050 (1995), *Southern Natural Gas Co.,* 65 FERC ¶ 61,348 (1993), and Commission Staff comments regarding a particular rate case filing schedule in *Northern Natural Gas Co.*, Docket No. RP04-155 (*see* R. 8, p. 9, JA 102) to show harmful effects of discounting. *See* Rehearing Order at P 56, JA 49-50.

Nonetheless, as the Commission explained:

> These specific Commission proceedings cited by the parties seeking rehearing do not support a finding that gas-on-gas discount adjustments have caused a significant cost shift to captive customers, requiring a drastic policy change seeking to discourage such discounts. Instead, they support the conclusion that individual rate cases provide the appropriate forum for determining the extent to which a discount adjustment for this type of discount is just and reasonable in the circumstances of the particular case. As IMGA points out, in the *Natural* decision, the circumstances resulted in the pipeline not implementing the full discount adjustment. Indeed, in its

> rehearing request, IMGA recognizes that Natural, and a second pipeline which faces substantial gas-on-gas competition, Gulf South Pipeline Company, have been able to engage in effective and efficient competition. As a result, they have not had to shift large amounts of costs to captive customers through discount adjustments. IMGA also recognizes that one factor in the ability of these pipelines to successfully compete has been the Commission's 1996 policy of permitting pipelines to negotiate rates using a different rate design from their recourse rates.

Rehearing Order at P 57, JA 50 (footnotes omitted). Further:

> In the *Southern* decision cited by IMGA, the parties reached a settlement. Moreover, in the [Reaffirmation Order] the Commission found that the testimony presented in that case concerning discounting practices of one interstate pipeline over ten years ago are not probative of the prevalence of gas-on-gas discounting by all interstate pipelines today. . . . [t]he issue of whether Northern should receive a full discount adjustment in connection with the CenterPoint discount has not been decided and parties will have an opportunity to address all the relevant facts concerning this discount in Northern's next rate case.

Id. at P 58, JA 50 (citing Reaffirmation Order at P 20, JA 7-8).

Therefore, the Commission appropriately concluded:

> Thus, the Commission finds that the responses to the [Notice of Inquiry] produced no evidence to support IMGA's allegation in its brief to the D.C. Circuit on the appeal of Order No. 637 that the discount adjustment for gas-on-gas competition has burdened captive customers by a cost "tilt of billions of dollars of costs." [*Interstate Natural Gas Ass'n*, 285 F.3d at 58] As a result, the Commission concludes that a continuation of its current general policy permitting pipelines to seek discount adjustments for gas-on-gas discounts in individual section 4 rate cases, with the ability to consider limits on a case-by-case basis, strikes the best balance between enabling the industry to obtain the benefits of such discounting discussed above, while minimizing the potential ill effects. Thus, the Commission rejects the request of IMGA and Northern Municipals that it establish a blanket rule prohibiting pipelines from proposing such a discount

adjustment in a section 4 rate case.

Rehearing Order at P 60, JA 51.

Finally, the Commission demonstrated the cited hypothetical example from the Commission's staff comments in the *Northern Natural Gas* case was not instructive because it was fundamentally flawed in that it was overly simplistic, and that the Petitioners failed to cite any case or real-life example to prove their argument. *See id.* at PP 63-66, JA 52-54. Therefore, the Commission reasonably found no basis for making any changes in the Commission's current policy.

D. Allowing Pursuit of Discount Adjustments Due to Competition with Capacity Release Is Appropriate and Reasonable

Petitioners next argue that permitting a pipeline to use a discounted throughput adjustment in competition with its firm shipper that is releasing capacity permits pipelines to use market power to the detriment of consumers, by undercutting their ability to recoup reservation charges through capacity release.[15] *See* Pet. Br. at 41-50. However, as the Commission's orders thoroughly explain, the Petitioners' view is incorrect. *See* Reaffirmation Order at PP 38-42, JA 14-16; Rehearing Order at PP 67-84, JA 54-60.

> The capacity release program[,] together with the Commission's policies on segmentation, and flexible point rights, has been

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[15] Capacity release refers to the right (authorized by FERC Order No. 636) of a firm transportation holder to assign that capacity on a temporary or permanent basis to the highest bidder.

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

Reaffirmation Order at P 41, JA 15. Moreover:

> Northern Municipals' argument misunderstands how increased throughput on the pipeline impacts the reservation charges of firm customers. Increased capacity sold by the pipeline, in competition with capacity release or otherwise, will not impact the *current* reservation charges paid by firm customers, but will reduce those charges *in the next rate case*. In a rate case, rates are determined by dividing the revenue requirement by the units of throughput. The higher the throughput, the lower the rates and, thus, if the pipeline's throughput during the rate case test period is increased due to discounting[,] the reservation charges in the next rate case will be lower than they would have been without the increased throughput. If firm shippers release capacity in competition with the pipeline and a replacement shipper buys the capacity from the shipper instead of the pipeline, then there will be no increase in the pipeline's throughput from that transaction to reduce rates in the next proceeding. But, the releasing shipper has instead received an immediate and direct benefit by making the sale of capacity and thereby recovered some of its reservation charges. When the Commission implemented Order No. 636, it recognized that competition from capacity release would reduce the amount of interruptible transportation service the pipelines would be able to sell. Therefore, in the Order No. 636 restructuring proceedings of individual pipelines, the Commission permitted the pipelines to reduce their allocation of costs to interruptible service. However, the Commission determined then, and reaffirms now, that enabling firm shippers to release their capacity when they are not using it and immediately recover some of their reservation charges provides a greater benefit that more than offsets the cost of any reduced allocation of fixed costs to interruptible service.

Rehearing Order at P 74, JA 56-57 (emphases in original). Finally,

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

Id. at P 83, JA 59.

E. The Orders Were Well-Reasoned Respecting Burden of Proof, Information Posting Requirements and Periodic Rate Cases

Finally, the Petitioners argue that the policy is arbitrary and capricious in three specific respects: (1) The Commission misapplied the burden of proof. Pet. Br. at 51-54. (2) The Commission's information posting requirements are not sufficiently stringent. *Id.* at 54-56. (3) The Commission should have required that pipelines file periodic rate cases. *Id.* at 56-61. These contentions are without merit.

1. The Commission appropriately allocated the burden of proof

Petitioners complain that "the Commission refused to place the 'real' initial burden of proof on pipelines to prove that a discount was necessary to meet competition." They claim that under the policy, "in a rate case, pipelines are

‘entitled to a “presumption’ that they will always seek the highest possible rate from shippers.” Pet. Br. at 18; *see also id.* at 51-54.

However, the orders demonstrate that the Commission properly allocated the burden of proof under the NGA. *See* Reaffirmation Order at PP 4, 51, 54, 59-66, JA 2, 18, 19, 20-22; Rehearing Order at PP 22, 37, 54-55, 61, 100-108, JA 35, 42, 49, 51, 65-68. For example, the Commission clarified:

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

Rehearing Order at P 100, JA 65. Further, the Commission explained that, notwithstanding Petitioners’ protests to the contrary, this allocation of the burden of proof was reasonable:

> Northern Municipals overstate the burden placed upon parties challenging a discount adjustment. Contrary to the assertions of

> Northern Municipals, the burden placed upon the opponents of the discount adjustment is not an unduly heavy burden. All the challenger of a discount adjustment must do, after the pipeline has explained generally the basis for its discounts, is produce some evidence that raises a reasonable question concerning whether the discount was required to meet competition.[[16]] Thus, Northern Municipals' concern that, in a rate case, "the opposing party's attempts to prove that the discounts were not necessary are invariably met with charges that they are using "twenty-twenty" hindsight to challenge the discounts" is unfounded. Contrary to Northern Municipals' assertion, the opponent of the discount is not required to prove that the discount was not given to meet competition, *but merely has to raise a reasonable question* as to the validity of the discount and the pipeline is required to show that it was made to meet competition. Further, the relevant inquiry is whether at the time the discount was given it was necessary to meet competition and this inquiry would not be dismissed as hindsight.

Id. at P 104, JA 66 (emphasis added). Further:

> It is not an undue burden to ask the parties opposing the discount adjustment to introduce some evidence that raises a question about the need for the discount. In a rate case where the discount adjustment is challenged, all parties have an opportunity to seek discovery of all the facts surrounding each discount. . . . In this regard, if a pipeline is unable in response to a discovery request to explain why competition required a particular discount, the Commission would regard that fact alone to raise a sufficient question concerning whether the discount was required to meet competition to shift the burden to the pipeline to justify the discount. . . . The pipeline must present evidence showing that the discount was required by competition and the opponents of the discount have an opportunity to challenge that evidence.

Id. at P 105, JA 66-67. Finally, the assumptions underlying this allocation of the burden of proof are reasonable:

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

> The Commission does not require the pipeline to initially present detailed evidence to substantiate that each discount was granted to meet competition because it assumes that, in the case of a discount to a non-affiliate, the pipeline will always seek the highest rate for its services because it is in its own best economic interests to do so. *The Commission can make assumptions about rational business behavior and a pipeline, like any other business, can be presumed to act in its own economic best interests.* Contrary to the parties' assertions here, the discount adjustment does not negate that assumption. There is no rational reason for a pipeline company to sell capacity at less that the highest rate it can charge. It would not be a good business practice for a pipeline to turn down the opportunity to put money in its pocket today through a higher rate in order to take a chance that the Commission will allow a discount adjustment in a future rate case.[[17]] There is no guarantee that the Commission will approve a discount adjustment and the Commission has denied pipelines this rate treatment when it has not been shown that the discounts were required by competition.[[18]]

Id. at P 107, JA 67-68 (emphasis added).

2. The Commission's information posting requirements are adequate

Petitioners next argue that pipelines should have been required to (1) post the reason for any discount given at the time the discount is given and (2) state the specific benefits to captive customers from these discounts. Pet. Br. at 18, 54-56.

However, as the Commission explained, the current Commission

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

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

information posting requirements are sufficient. *See* Reaffirmation Order at PP 78-80, JA 25; Rehearing Order at PP 123-126, JA 73-74. As the Commission stated:

> As explained in the [Reaffirmation] Order, under section 284.13(b) of the Commission's regulations [18 C.F.R. § 284.13(b)], pipelines are required to post on their website information concerning any discounted transactions, including the name of the shipper, the maximum rate, the rate actually charged, the volumes, receipt and delivery points, the duration of the contract, and information on any affiliation between the shipper and the pipeline. Further, section 358.5(d) of the regulations [18 C.F.R. § 358.5(d)] requires pipelines to post on their website any offer of a discount at the conclusion of negotiations contemporaneous with the time the offer is contractually binding. This information provides shippers and the Commission with the price transparency needed to make informed decisions and to monitor transactions for undue discrimination and preference. As the court stated in [*Associated Gas Distributors,* 824 F.2d at 1009,] "the reporting system will enable the Commission to monitor behavior and to act promptly when it or another party detects behavior arguably falling under the bans of [NGA] §§ 4 and 5."

Rehearing Order at P 125, JA 73-74. Thus, the Commission acted within its discretion not to expand the scope of its reporting requirements.

3. There is no basis for the Commission to require periodic rate cases

Petitioners' final argument is that the Commission should have revised its regulations to require pipelines that elect to use a discounted throughput adjustment to file periodic rate cases. Petitioners argue that no benefits to consumers can be achieved unless and until a new base rate case is filed and periodic filings would ensure that such benefits – to the extent any are actually

realized – would actually flow to consumers. Pet. Br. at 18-19, 56-61.[19] However, as the Commission explained, the policy statement does not provide a basis for requiring pipelines to file periodic rate cases under either section 4 or section 5 of the NGA. *See* Reaffirmation Order at PP 67-77, JA 22-24; Rehearing Order at PP 117-122; JA 71-73. As the Commission summarized:

> Under section 4 of the NGA, the Commission is required to ensure that rate changes proposed by the pipeline are just and reasonable, and under section 5, if the Commission finds that the existing rate is unjust or unreasonable, it must establish the just and reasonable rate for the future. This is the statutory scheme under the NGA and it gives the Commission sufficient authority to ensure that pipeline rates are just and reasonable. A requirement that pipelines file periodic rate cases is not part of the statutory scheme, and the Commission's authority to require such filings is limited.[[20]] As the Commission stated in the [Reaffirmation] Order, under this statutory scheme, the decision to file a rate case is always that of the pipeline and it may choose to file a rate at a time that it is advantageous for it to do so. The "shortcomings" Northern Municipals perceive[] in section 5 as a

[19] Petitioners' argument is somewhat paradoxical. On one hand, they claim that discounting adjustments regarding gas-on-gas competition can cause nothing but harm to captive customers. If Petitioners are correct in this, then logic would dictate that they would want to prevent or delay the filing a rate case so as to avoid this harm as long as possible. Yet, Petitioners insist that the Commission force pipelines to file periodic rate cases so that these same customers can reap the benefits of these same discounts. This is reminiscent of the line from the motion picture, ANNIE HALL (United Artists 1977) where the main character, Alvy Singer, addresses the camera and states, "There's an old joke - um... two elderly women are at a Catskill mountain resort, and one of 'em says, 'Boy, the food at this place is really terrible.' The other one says, 'Yeah, I know; and such small portions.'"

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

> remedy are part of the statutory scheme. The fact that under section 5 the burden of proof is on the complainant and that relief is prospective only does not give the Commission authority to order periodic rate filings under section 4.

Rehearing Order at P 120, JA 72. Further, the Commission confirmed that, contrary to Petitioners' claims, the discount policy statement is dissimilar from a Purchased Gas Adjustment clause (which requires periodic filings) and therefore does not necessitate similar treatment. *See* Reaffirmation Order at PP 74-76, JA 24; Rehearing Order at PP 121-122, JA 72-73.

Therefore, the Commission was correct in finding that "There is no mechanism under the selective discount policy that permits shippers' rates to change between rate cases. The rates of other shippers on the system remain at the level determined to be just and reasonable in the pipeline's last section 4 rate case and are not affected until the next rate case is filed. In these circumstances a requirement that pipelines file periodic rate cases is not justified." Rehearing Order at P 122, JA 72-73.

CONCLUSION

For the reasons stated, the petitions for review should be dismissed for lack of jurisdiction or, in the alternative, denied on their merits.

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Illinois Municipal Gas Agency, et al. v. FERC,
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CERTIFICATE OF COMPLIANCE

In accordance with Circuit Rule 28(d)(1), I hereby certify that this brief contains 12,929 words, not including the tables of contents and authorities, the glossary, the certificate of counsel and this certificate.

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