UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Williston Basin Interstate Pipeline Co. Docket No. RP00-463-006

SECOND ORDER ON REMAND

(Issued March 3, 2005)

1. On June 1, 2004, the Commission issued an order (June 1 Order) in *Williston Basin Interstate Pipeline Co.*,[1] seeking comments on the Commission's policy concerning a shipper's retention of its discounted rates when a secondary point is used, as that policy has been modified by the decisions in *Colorado Interstate Gas Co. (CIG)*[2] and *Granite State Transmission Co.* (*Granite State*).[3] The June 1 Order was issued in response to the decision of the United States Court of Appeals for the District of Columbia Circuit in *Williston Basin Interstate Pipeline Co. v. FERC*,[4] vacating the Commission's decisions in *Williston Basin Interstate Pipeline Co*.[5] The Commission's decisions addressed Williston Basin Interstate Pipeline Company's (Williston) filing to comply with Order Nos. 637, 587-G, and 587-L.

2. As discussed below, upon consideration of the comments, the Commission has determined that it cannot at this time show pursuant to section 5 of the Natural Gas Act that the benefits of the *CIG/Granite State* policy in increasing competition outweigh the disadvantages of potentially discouraging pipelines from using selective discounting to increase throughput. The Commission further finds that the Commission's discount policy as set forth in *El Paso Natural Gas Co. (El Paso)*[6] more appropriately balances the

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[1] 107 FERC ¶ 61,229 (2004).

[2] 95 FERC ¶ 61,321 (2001).

[3] 96 FERC ¶ 61,273 (2001).

[4] 385 F.3d 45 (D.C. Cir. 2004).

[5] 98 FERC ¶ 61,212 (2002), *reh'g*, 99 FERC ¶ 61,327 (2002).

[6] 62 FERC ¶ 61,311 at 62,990-91.

goals of the selective discount policy with the Commission's goals in adopting its segmentation and flexible point rights policies of enhancing competition. This order is in the public interest because it preserves the benefits of pipeline selective discounting for captive customers.

I. Background

A. The Commission's Discount Policy

3. As set forth in greater detail in the June 1 Order, the Commission adopted in Order No. 436 regulations permitting pipelines to engage in selective discounting based on the varying demand elasticities of the pipeline's customers.[7] The Commission explained that these selective discounts would benefit all customers, including customers that did not receive the discounts, because the discounts allow the pipeline to maximize throughput and thus spread its fixed costs across more units of service.[8] In the Rate Design Policy Statement[9] and a number of section 4 rate cases,[10] the Commission held that, in the next rate case after giving selective discounts, the pipeline is permitted to reduce the discounted volumes used to design its rates to reflect discounting so that, assuming

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[7] Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, FERC Stats. & Regs. Regulations Preambles 1982-1985 ¶ 30,665 at 31,543-45 (1985); Order No. 436-A, FERC Stats. & Regs. Regulations Preambles 1982-1985 ¶ 30,675 at 31,677-80 (1985). 18 C.F.R § 284.10(c)(5). The Commission's adoption of these regulations was upheld in *Associated Gas Distributors v. FERC (AGD I)*, 824 F.2d 981, 1010-1012 (D. C. Cir. 1987).

[8] Order No. 436 at 31,544.

[9] 47 FERC ¶ 61,295 at 62,056 - 57 (1989).

[10] *See*, *e.g*., *Southern Natural Gas Co.*, 65 FERC ¶ 61,347 at 62,829-62,833 (1993), *reh'g denied*, 67 FERC ¶ 61,155 at 61,456-61,460 (1994); *Williston Basin Interstate Pipeline Co*., 67 FERC ¶ 61,137 at 61,377-61,282 (1994); *Panhandle Eastern Pipe Line Co.*, 71 FERC ¶ 61,228 at 61,866-61,871 (1995) (Opinion No. 395); *Northwest Pipeline Corp.*, 71 FERC ¶ 61,253 at 62,007-61,009 (1995); *Panhandle Eastern Pipe Line Co.*, 74 FERC ¶ 61,109 at 61,399-61,408 (1996) (Opinion No. 404); *Williams Natural Gas Co.*, 77 FERC ¶ 61,277 at 62,205-61,207 (1996), *reh'g denied*, 80 FERC ¶ 61,158 at 61,189-61,190; *Iroquois Gas Transmission System, L.P.*, 84 FERC ¶ 61,086 at 61,478 (1998), *reh'g denied*, 86 FERC ¶ 61,261 (1999); *Williston Basin Interstate Pipeline Co*., 84 FERC ¶ 61,266 at 61,401- 61,402(1998); *Northwest Pipeline Corp.*, 87 FERC ¶ 61,266 at 62,077 (1999); and *Trunkline Gas Co.*, 90 FERC ¶ 61,017 at 61,084-61,096 (2000).

market conditions require it to continue giving the same level discounts that it gave during the test period when the new rates are in effect, the pipeline will not bear the cost responsibility for discounts necessary to meet competition.

4. As part of the changes to the structure of pipeline service adopted in Order No. 636, the Commission adopted the capacity release program that permits holders of firm transportation rights on a pipeline to resell those rights to other shippers. This capacity release mechanism is intended to create a robust secondary market for capacity where the pipeline's direct sale of its capacity must compete with its firm shippers' offers to release their capacity. Order No. 636 also adopted a policy giving firm shippers the right to use, on a secondary basis, receipt and delivery points other than the primary points listed in their contracts. This permits them to receive and deliver gas to any point within the firm capacity rights for which they pay. As the Court recognized in *INGAA v. FERC*,[11] Order No. 636's establishment of flexible point rights, as well as segmentation, was intended to enhance the value of firm capacity and promote competition in the secondary market between firm shippers releasing capacity and pipelines, as well as between releasing shippers themselves.

5. In the individual pipeline restructuring proceedings to comply with Order No. 636, the question arose whether a shipper paying a discounted rate may retain that discount if it or its replacement shipper uses points other than the releasing shipper's primary points. In *El Paso Natural Gas Co.*,[12] the Commission held that if the pipeline's contract with a shipper limits its discount to its primary point, the pipeline could require the shipper to pay the maximum rate whenever it or its replacement shipper uses a different point. The Commission explained that the market considerations justifying the discount at the primary point "may not be relevant at the alternative delivery point when the shipper wishes to flex to that point."[13] The releasing shipper, rather than the replacement shipper, would be responsible for paying any difference between the maximum rate and the replacement shipper's rate, because the replacement shipper's reservation charge is established through the bidding or other procedures set forth in the pipeline's tariff. The Commission also stated that the releasing shipper could protect itself by putting a condition in the release preventing the use of alternate points.

[11] 285 F.3d 18, 36 (D.C.Cir. 2002).

[12] 62 FERC ¶ 61,311 at 62,990-91 (1993).

[13] *Id*. at 62,990.

6. In Order No. 637, the Commission took additional actions to enhance flexibility and competition in the secondary market. Among other things, Order No. 637 revised the Part 284 regulations to require pipelines to permit a firm shipper to segment its capacity either for its own use or for the purpose of capacity release, where operationally possible. While Order No. 637 did not change the Commission's policy on selective discounting, the Commission stated that the policy of permitting a pipeline to limit a shipper's discount to its primary point needed to be reexamined in the compliance filings, as part of the examination of restrictions on capacity release and segmentation. The Commission explained in Order No. 637-B[14] that it was concerned that requiring a releasing shipper with a discounted rate to pay the maximum rate in order to effectuate a segmented or release transaction could interfere with the competition created by capacity release.

7. *CIG* was the first Order No. 637 compliance proceeding where the Commission addressed how to resolve the tension between the Commission's selective discounting policy and the Commission's goal in adopting its segmentation and flexible point right policies of enhancing competition. The Commission explained that if a shipper always loses its primary point discount and is always required to pay the maximum rate when it uses a secondary point or segments its capacity, the shipper will be less likely to engage in these activities and competition will be restricted. On the other hand, the Commission recognized that if a shipper always retains its discount when it utilizes secondary points, discounts could be allowed at non-competitive points. Therefore, the Commission refined its discount policy such that if a pipeline provides a discount at any point, a shipper that segments to that point or uses that point on a secondary basis is entitled to the same discount if it is similarly situated to the shipper receiving the discount from the pipeline. In *Granite State*, the Commission amended its holding in *CIG* to require pipelines to process shipper requests to retain discounts in no longer than two hours from the time the request is submitted.

B. The Williston Decisions

8. In Williston's Order No. 637 compliance filing, the Commission required Williston to implement the discount policies set forth in *CIG/Granite State*. On rehearing, Williston argued that the *CIG/Granite State* discount policy undercuts its ability to target firm service discounts to specific points in order to encourage the shipper to flow gas in a manner that will permit Williston to maximize the capacity of its reticulated system. Williston also argued that the policy would allow a firm shipper to obtain a long-term discount for an underutilized portion of its system and then engage in short-term discounted transactions at different receipt and delivery points. Williston asserted that this could reduce interruptible throughput in heavily utilized portions of its

[14] 92 FERC at 61,167-68.

system while failing to increase flow at the point where the discount was originally given and where additional throughput was needed. Williston also argued that the policy is harmful because it limits its ability to grant discounts to obtain long-term firm service commitments and that application of the policy is not appropriate on its reticulated system.

9. The Commission concluded that shippers could not misuse the discounts in the manner described by Williston because, under the *CIG/Granite State* policy, the firm shipper changing points would pay the greater of its own discounted rate or the prevailing discount at the alternate point. Thus, the Commission stated, the shipper on the less utilized portion of the system could not shift its deeper discount to the more heavily utilized portion of the system. The Commission acknowledged that this new policy may require changes in long-term contracting, but stated that the policy change was nevertheless necessary to resolve the conflict between enhancing competition by adopting segmentation and flexible point rights and continuing to permit pipelines to restrict discounts to specific shippers at specific points.

10. In *Williston Basin Interstate Pipeline Co.*,[15] the Court vacated the Commission's decisions in *Williston* on essentially two grounds. First, the Court held that the Commission had not adequately addressed whether the application of the *CIG/Granite State* policy in this case was appropriate in light of Williston's individual circumstances, particularly the reticulated nature of its system. The Court found that the Commission had not addressed Williston's contention that the policy could adversely affect its ability to use targeted discounts to manage gas flows across its system, in order to maximize its capacity and system utilization. Second, the Court held that the Commission had not adequately justified the general policy established in *CIG/Granite State* concerning retention of discounts when secondary points are used. The Court observed that the purpose of selective discounting is to increase throughput by allowing price discrimination in favor of demand-elastic customers, but a pipeline is unlikely to be able to increase throughput by selective discounting if capacity at secondary points can be transferred readily among shippers through resale at a discounted rate. The Court stated that "economic theory tells us price discrimination, of which selective discounting is a species, is least practical where arbitrage is possible – that is, where a low-price buyer can resell to a high price buyer. . . . Yet this is precisely what the Commission's policy would appear not only to allow but to encourage." 358 F.3d at 50. Therefore, the Court was concerned that the *CIG/Granite State* policy undermines the benefits of selective discounting. The court remanded the case to the Commission.

[15] 358 F.3d 45 (D.C. Cir. 2004).

C. The June 1, 2004 Order and the Comments

11. In response to the court's decision, the Commission issued an order on remand[16] seeking comments from interested parties on the *CIG/ Granite State* policy. The Commission stated that the court's decision raised questions concerning the effect of the discount policy on a generic basis as well as on individual pipelines, and, thus, asked for comments on the general policy issues as well as the impact of the policy on Williston and other interested pipelines and shippers. The Commission stated that it would permit any interested party to intervene in this proceeding.

12. Initial Comments were filed by seven parties representing pipelines, *i.e.*, Duke Energy Gas Transmission and the DEGT pipelines[17] (collectively, Duke), Gulf South Pipeline Co., LP (Gulf South), Horizon Pipeline Co., Kinder Morgan Interstate Pipelines (Kinder Morgan), Tennessee Gas Pipeline Co. (Tennessee), Williston Basin Interstate Pipeline Co. (Williston), and INGAA. Three shippers on pipelines other than Williston, BP America Production Co. and BP Energy Co. (BP), Dominion Resources, Inc. (Dominion),[18] and ProLiance Energy (ProLiance), filed initial comments. Reply comments were filed by INGAA, Tennessee, Williston, BP, and Nisource Distribution Companies.[19] The parties also filed motions to intervene except for Williston and Tennessee which were already parties in the proceeding. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.214 (2004)), the motions to intervene are granted.

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[16] 107 FERC ¶ 61,229 (2004).

[17] The DEGT Pipelines are Algonquin Gas Transmission, LLC, East Tennessee Natural Gas, LLC, Texas Eastern Transmission LP, Egan Hub Storage, LLC, Maritimes and Northeast Pipeline, L.L.C., and Gulfstream Natural Gas System, LLC.

[18] Dominion's subsidiaries include two interstate pipelines, three local distribution companies, and gas marketing companies.

[19] The Nisource Distribution Companies are Bay State Gas Co., Columbia Gas of Kentucky, Columbia Gas of Maryland, Columbia Gas of Ohio, Columbia Gas of Pennsylvania, Inc., Columbia Gas of Virginia, Inc., Kokomo Gas and Fuel Co., Northern Indiana Fuel & Light Co., Northern Indiana Public Service Co. and Northern Utilities, Inc. Nisource Distribution Companies addressed its comments solely to whether a releasing shipper or a replacement shipper should be responsible for payment of any additional charges resulting from its use of alternate delivery or receipt points, an issue not directly relevant to the Commission's inquiry.

13. Generally, the pipeline commenters oppose the *CIG/Granite State* policy and argue that it is inconsistent with law and Commission policy and results in harmful effects in the natural gas market. They argue that the rebuttable presumption in the *CIG/Granite State* policy is not valid, that the Commission improperly defined the "similarly situated" test, that the Commission has failed to recognize the fundamental differences between firm and interruptible service, that the Commission failed to meet the section 5 requirements to support its change in policy, and that the policy improperly interferes with private contracts, contrary to the *Mobile-Sierra* doctrine.[20] In addition, the pipeline commenters argue that the policy undercuts the benefits of selective discounting for captive customers, increases the opportunity for arbitrage, and lessens the incentive to discount. The pipelines support a return to the *El Paso* policy.[21] They argue that the *El Paso* policy is consistent with Commission precedent, is simple to apply, and encourages discounting to the benefit of captive shippers. Further, they state that there is no evidence that pipelines have failed, under the *El Paso* policy, to grant discounts at secondary points where economically viable.

14. Only three shippers filed comments supporting the *CIG/Granite State* policy. They argue that it will not have the negative consequences in the natural gas market alleged by the pipelines and that it will maximize competition and shipper flexibility. They oppose a return to the *El Paso* policy and assert that that policy gives pipelines too much discretion as to whether to grant discounts and would reduce competition.

15. The Commission also sought information concerning how the *CIG/Granite State* policy has affected discounting practices. The responses indicated that the pipelines have received very few requests for discounts under the policy.[22]

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[20] FPC v. Sierra Pacific Power Co., 350 U.S. 348 (1956); United Gas Pipeline Co. v. Mobile Gas Service Corp., 350 U.S. 332 (1956).

[21] In El Paso Natural Gas Co., 62 FERC ¶ 61,311 at 62,990-91 (1993), the Commission held that, if the pipeline's contract with the releasing shipper limited its discount to its primary points, the pipeline could require the releasing shipper to pay the maximum rate whenever its replacement shipper used a different point.

[22] Tennessee stated that it received two such requests; it granted one and denied the other based on the similarly situated test. Kinder Morgan stated that it received one such request, and denied it because it did not meet the similarly situated test. Williston stated that it had not entered into any firm transportation discount transactions since the issuance of the *CIG/Granite State* policy.

III. Discussion

16. Upon review of the comments and in light of the Court's decision, the Commission has concluded that it cannot, at the present time, satisfy its burden under NGA section 5 to require Williston or other pipelines to modify their tariffs to incorporate the *CIG/Granite* State policy. Accordingly, the Commission will return to its preexisting policy of permitting pipeline to limit the selective discounts they offer shippers to particular points.

17. Since the adoption of Order No. 636, the Commission has sought to balance two different approaches to pricing pipeline capacity. The first approach is the selective discounting policy which the Commission adopted in Order No. 436. This approach has "an established place" in an "industry marked by a degree of natural monopoly."[23] Under selective discounting, regulated entities with market power (here pipelines) are permitted to "engage in price discrimination in favor of demand elastic customers" in order "to increase throughput."[24] This is considered to benefit captive customers by allowing the pipeline to obtain from customers with alternatives "a contribution to fixed costs that otherwise would not be made at all."[25]

18. By contrast, as the court recognized when it affirmed Order No. 436's selective discounting policy, if a market is "roughly competitive," "there is no economic justification for charging different prices based on the purchasers' differing access to substitutes (*i.e.*, price elasticities). Indeed, if a product is produced under competitive conditions, such price discrimination cannot occur unless a bottleneck with market power stands between it and the customers."[26] Thus, under the competitive approach to pricing pipeline capacity, the price discrimination inherent in a selective discounting policy is not appropriate.

19. In Order No. 636, the Commission moved in the direction of the competitive model by requiring pipelines to permit capacity release (a secondary market in pipeline capacity) and the use of flexible points. This brought competition into the capacity market between the pipeline's sale of capacity, particularly on an interruptible basis, and capacity release. As a result, capacity release made it more difficult for pipelines to obtain additional throughput through selective discounting. Indeed, Order No. 636

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[23] *Associated Gas Distributors v. FERC*, 824 F.2d 981,1010-1 (D.C. Cir. 1987).

[24] *United Distribution Companies v. FERC*, 88 F.3d 1105, 1142 (D.C. Cir. 1996).

[25] *Id*. at 1011.

[26] *Id*.

expressly recognized that capacity release would reduce the pipeline's sale of interruptible service, since potential purchasers of interruptible service would have the option of purchasing released firm capacity.

20. However, consistent with the selective discounting policy, the Commission sought to retain at least some of the benefits of selective discounting for captive customers by permitting pipelines to limit a shipper's discount to its primary point. This policy minimized any disincentive to discounting that the capacity release program might otherwise have created, since it eliminated the possibility that a discount provided to obtain additional throughput at competitive points could be transferred to other less competitive points. However, at the same time, this policy created a disincentive for discounted rate shippers to release their capacity for use at other points in competition with the pipeline's sale of its own capacity at those points, since such activities would require the discounted rate shipper to lose its discount.

21. The *CIG/Granite State* policy was an effort to increase the competitive benefits of capacity release by minimizing disincentives for discounted rate shippers to engage in capacity release. It did this by limiting the pipeline's ability to require discounted rate shippers to pay the maximum rate if they engaged in capacity release and the replacement shipper used a different point. However, the court has raised the concern that the Commission's *CIG/Granite State* policy undermines the benefits of selective discounting by creating the potential for arbitrage. The court stated that "economic theory tells us price discrimination, of which selective discounting is a species, is least practical where arbitrage is possible – that is, where a low-price buyer can resell to a high price buyer. . . . Yet this is precisely what the Commission's policy would appear not only to allow but to encourage."[27]

22. Based on the comments received, the Commission cannot support a finding under section 5 of the Natural Gas Act that any benefits of increased competition achieved by the *CIG/Granite State* policy outweigh the costs of reduced selective discounting. The comments indicate that the *CIG/Granite State* policy has reduced the incentive of pipelines to seek to increase the sale of firm capacity through selective discounting by permitting discounted rate firm shippers to transfer their discounts to other shippers and other points. These commenters state that the policy creates uncertainty and risk of frustration of the pipeline's purpose in granting a discount, thereby discouraging pipelines from entering into such transactions. The policy's effect of discouraging selective discounts may be particularly severe on reticulated pipelines and reticulated portions of systems where discounts are given to attract flow to specific areas to maximize system capacity and promote efficient operations. If the *CIG/Granite State*

[27] 358 F.3d at 50.

policy enables a shipper to transfer an operationally based discount to another point where the pipeline does not need to discount in order to attract throughput, then the operational benefits of granting the discount are lost. In fact, Williston states that it had not entered into firm transportation discount transactions since the issuance of the *CIG/Granite State* policy.

23. Further, the comments suggest that the adoption of the *CIG/Granite State* policy has not significantly increased competition in the capacity market. The information submitted by the pipelines in their comments indicates that they have rarely received requests for discounts under the *CIG/Granite State* policy. Tennessee states that it received only two such requests; it granted one and denied the other based on the similarly situated test. Kinder Morgan states that it received only one such request and denied it because it did not meet the similarly situated test. Also, very few shippers filed comments supporting retention of the *CIG/Granite State* policy.

24. Therefore, the Commission has concluded that the *CIG/Granite State* policy does not provide the anticipated benefits to shippers and may in fact harm captive customers by discouraging pipelines from offering selective discounts. Accordingly, the Commission will not require pipelines to depart for the *El Paso* policy at this time. However, the Commission is taking a more comprehensive review of its discount policy in Docket No. RM05-2-000, and will take a broader look at the discount policy in that proceeding.

25. The Commission vacates the requirement in the orders in Williston's Order No. 637 proceeding requiring Williston to implement the *CIG/Granite State* policy. Within 15 days of the date of this order, Williston may file to eliminate its tariff provisions implementing that policy. In addition, other pipelines who implemented the *CIG/Granite State* policy pursuant to orders that are now final may file pursuant to NGA section 4 to remove their tariff provisions implementing that policy.

The Commission orders:

Within 15 days of the date of this order, Williston may file to remove from its tariff the provisions implementing the *CIG/Granite State* policy.

By the Commission.

(S E A L)

Linda Mitry,
Deputy Secretary.