ORAL ARGUMENT IS NOT YET SCHEDULED

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

No. 05-1339

NORTH CAROLINA UTILITIES COMMISSION,
PETITIONER,

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

JOHN S. MOOT
GENERAL COUNSEL

ROBERT H. SOLOMON
SOLICITOR

BETH G. PACELLA
SENIOR ATTORNEY

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, DC 20426

DECEMBER 8, 2006

CIRCUIT RULE 28(a)(1) CERTIFICATE

A. Parties and Amici

All parties appearing before the Commission and this Court are listed in Petitioner's Rule 28(a)(1) certificate.

B. Rulings Under Review:

The rulings under review appear in the following orders issued by the Federal Energy Regulatory Commission:

1. *Transcontinental Gas Pipe Line Corporation*, 106 FERC ¶ 61,299 (2004); and

2. *Transcontinental Gas Pipe Line Corporation*, 112 FERC ¶ 61,170 (2005).

C. Related Cases:

This case has not previously been before this Court or any other court. Two other cases currently pending in this Court challenge different aspects of the orders challenged here: (1) *Consolidated Edison Co. of New York v. FERC*, D.C. Cir. No. 06-1275; and (2) *Transcontinental Gas Pipe Line Corp. v. FERC*, D.C. Cir. No. 06-1286.

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Beth G. Pacella
Senior Attorney

December 8, 2006

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GLOSSARY

ALJ	Administrative Law Judge
Commission	Federal Energy Regulatory Commission
FERC	Federal Energy Regulatory Commission
Initial Decision	*Transcontinental Gas Pipe Line Corp.*, 101 FERC ¶ 63,022 (2002)
NGA	Natural Gas Act
North Carolina	North Carolina Utilities Commission
Order on Initial Decision	*Transcontinental Gas Pipe Line Corp.*, 106 FERC ¶ 61,299 (2004)
Rehearing Order	*Transcontinental Gas Pipe Line Corp.*, 112 FERC ¶ 61,170 (2005)
Transco	Transcontinental Gas Pipe Line Corporation
Williams	Williams Communication Company

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BRIEF FOR RESPONDENT FEDERAL ENERGY REGULATORY COMMISSION

STATEMENT OF THE ISSUE

Whether the Federal Energy Regulatory Commission ("FERC" or "Commission") reasonably affirmed the determination of its administrative law judge ("ALJ"), in a ratemaking proceeding, that Petitioner North Carolina Utilities Commission ("North Carolina") failed to raise a serious doubt about the prudence of an agreement between a natural gas pipe line company and its telecommunications affiliate.

STATUTORY AND REGULATORY PROVISIONS

The pertinent statutory and regulatory provisions are contained in the Appendix to this Brief.

INTRODUCTION

North Carolina seeks review of Commission rate orders affirming an ALJ's determination that North Carolina failed to raise a serious doubt about the prudence of an agreement between Transcontinental Gas Pipe Line Corporation ("Transco") and a telecommunications affiliate, Williams Communication Company ("Williams"). *Transcontinental Gas Pipe Line Corp.*, 106 FERC ¶ 61,299 (2004) ("Order on Initial Decision"), *order on reh'g*, 112 FERC ¶ 61,170 (2005) ("Rehearing Order"). Under that agreement, Transco agreed not to object to Williams obtaining its own right-of-way for a new fiber optic cable in exchange for Williams providing Transco the use of two "dark" fibers in that cable.

Both the ALJ, initially, and the Commission, on review, found that North Carolina's claim was premised on its mistaken belief that Transco had transferred its own right-to-way to Williams. *Transcontinental Gas Pipe Line Corp.*, 101 FERC ¶ 63,022 (2002) ("Initial Decision") at P 333, JA 152; Order on Initial Decision at P 218, JA 156; Rehearing Order at P 127, JA 159. Moreover, the ALJ and the Commission found that the agreement provided Transco the use of fiber optics, which benefited Transco's ratepayers. Initial Decision at PP 334-35, JA

152-53; Order on Initial Decision at P 218, JA 156. Accordingly, the ALJ and the Commission determined that there was no basis to find the agreement imprudent and, therefore, to reduce Transco's rate base or provide Transco's ratepayers a credit. Initial Decision at P 336, JA 153; Rehearing Order at P 127, JA 159.

STATEMENT OF FACTS

I. Statutory And Regulatory Background

"The Natural Gas Act requires that 'all rates and charges made, demanded, or received by a natural gas company . . . be just and reasonable' and declares 'any such rate or charge that is not just and reasonable . . . unlawful." *ChevronTexaco Exploration & Production Co. v. FERC*, 387 F.3d 892, 895 (D.C. Cir. 2004) (quoting Natural Gas Act ("NGA") Section 4, 15 U.S.C. § 717c). "The pipeline bears the burden of showing its proposed rate is just and reasonable." *Chevron Texaco*, 387 F.3d at 895.

The pipeline is "not[, however,] required to demonstrate in [its] case-in-chief that all expenditures are prudent." *Anaheim v. FERC*, 669 F.2d 799, 809 (D.C. Cir. 1981) (internal quotation omitted). Rather, a pipeline's expenditures are presumed prudent. *Iroquois Gas Transmission System, L.P. v. FERC*, 145 F.3d 398, 399-400 (D.C. Cir. 1998). If "some other participant in the proceeding creates a serious doubt as to the prudence of an expenditure, then the applicant has the burden of dispelling these doubts and proving the questioned expenditure to have been

prudent." *Anaheim*, 669 F.2d at 809 (internal quotation omitted); *see also Iroquois*, 145 F.3d at 399-400 ("a natural gas company is ordinarily not required to show that all of its expenditures were prudent unless serious doubts are raised regarding the prudence of those costs") (internal quotation omitted)).

II. Events Leading To The Challenged Orders

A. Transco's Rate Filing

On March 1, 2001, Transco filed revised tariff sheets in support of a proposed general NGA § 4 rate increase. R. 1. After determining that Transco's filing raised issues requiring further investigation, the Commission set the matter for hearing before an ALJ. *Transcontinental Gas Pipe Line Corp.*, 94 FERC ¶ 61,360 at 62,300, *order on reh'g*, 95 FERC ¶ 61,268 (2001) (R. 91, 113). On July 23, 2002, the Commission approved an uncontested partial settlement, R. 254, which resolved many, but not all, of the issues in the rate case. *Transcontinental Gas Pipe Line Corporation*, 100 FERC ¶ 61,085 at PP 9-10 (2002) (R. 353).

B. North Carolina's Prudence Claim

One of the matters reserved for hearing was North Carolina's claim that an agreement between Transco and Williams, a Transco affiliate, was not entered into prudently. R. 254 at 32-34; JA 2-3. In North Carolina's view, Transco had received inadequate consideration for Transco's purported agreement to "provide[] [Williams] access to its right-of-way for the construction, operation, and

maintenance of a fiber-optic telecommunication system." R. 382 at 2, JA 145 (citing R. 759 (Ex. T-56 at 2), JA ___) (internal quotation omitted).

Transco explained, however, that its pipeline right-of-way consisted "overwhelmingly of pipeline easements negotiated and purchased from third party landowners." R. 378 at 66, JA 146 (citing Ex. T-55 at 4-5, JA 70-71; Ex. T-56 (examples of typical Transco easement agreements)).

> Under these easements, Transco is permitted to install, operate and service its own pipelines, but that is *all* that it is entitled to do. . . . That is, under those easements, Transco does not have a right to permit *others* to use, for their own separate purposes, the land on which it has the easements. Ex. T-55, pp. 5-6[, JA 71-72]; Tr. 1453, 1476, 1492[, JA 103, 104, 108]. Others wishing to use the land for their own purposes must negotiate and purchase their *own* easements from landowners. *Id.*

R. 378 at 66, JA 146. Thus:

> In 1997, Transco and its then-affiliate [Williams] entered into an agreement in which, for its part, Transco agreed not to object to [Williams] separately obtaining from the landowners its *own* 18-inch [right-of-way] for a new fiber optic cable. . . . In exchange for such non-objection, [Williams] gave Transco an indefeasible right of use . . . of two "dark" fibers in its new cable for Transco's telecommunications use in its jurisdictional operations. Exs. T-55, pp. 3-4, 6-9[, JA 69-70, 72-75]; T-57, pp. 4, 16-17, 20-21[, JA 90, 98-99, 100-101].

R. 378 at 67, JA 147.

This "transaction enabled Transco, at a relatively modest cost, to convert the backbone of its own telecommunications system to a new, state-of-the-art system with ample capacity and future flexibility to serve the pipeline for well over a

decade (indeed, perhaps for decades) into the future." *Id.* (citing Ex. T-55 at 7-8, JA 73-74; Tr. 1482, 1491-92, 1527-28, 1549-50, JA 105, 107-08, 115-16, 122-23).

C. The ALJ's Initial Decision

The ALJ found that North Carolina[1] "did not meet [its] burden on this issue." Initial Decision at P 333, JA 152. First, North Carolina did not "offer[] convincing evidence . . . showing that somehow Transco gave its own existing [right-of-way] to [Williams]. Instead, the evidence demonstrates that Transco agreed not to object when [Williams] sought to obtain its own [right-of-way] from [landowners] along Transco's existing [right-of-way]." *Id.* (citing Ex. No. T-55 at 6, JA 72; Ex. No. T-57 at 13-14, JA 96-97; Tr. 1476, 1485, 1547-49, JA 104, 106, 120-22).

Furthermore, the ALJ found, while the agreement may have benefited Williams significantly, "that does not demonstrate that Transco's existing customers should receive a revenue credit or a reduction in rate base. Nowhere in the record has [North Carolina] demonstrated that existing customers have, in any

[1] Because North Carolina sponsored a witness jointly with Johns Hopkins University, the Initial Decision and Commission Orders referred to these parties collectively as "Johns Hopkins." *See* Initial Decision at P 333, JA 152.

way, specifically funded the arrangement between Transco and [Williams]." *Id.* On the other hand, "Transco, in return for its agreement not to object, received two dark fibers in the exchange – a valuable asset, enhancing Transco's jurisdictional services." *Id.* at P 334, JA 152.

That Transco would have to pay $4.6 million to light the fibers did not indicate that the agreement was imprudent. *Id.* "[T]hese fibers are only used to support the functions of the pipeline, and, therefore, the related costs should be borne by rate payers." *Id.* at P 334, JA 152-53. If Transco had "built the fiber optic system itself, the rate payers would bear that expense. This presents a situation that would exist in either event which does not argue in favor for the relief [North Carolina] seek[s] in this instance." *Id.* at P 334, JA 153.

In fact, if Transco had "undertaken the cost and effort to upgrade its existing communications system before it entered into the agreement with [Williams], it would have cost its ratepayers much more than just the $4.6 million to light the fibers, and an agreement not to object." *Id.* at P 335, JA 153 (citing R. 378 at 68, JA 148 (explaining that a 1993 Transco study determined that it would cost $16-24[2] million to replace Transco's old analog system with the superior fiber optic

[2] The 1993 study actually determined that it would cost $24-60 million to replace Transco's old analog system with the superior fiber optic system. Ex. T-55 at 7, JA 73.

system) (citing Ex. T-55 at 7-8, JA 73-74; Tr. 1482, 1491-92, 1527-28, 1549-50, JA 105, 107-08, 115-16, 122-23)). Thus, the ALJ concluded, "[t]hough this does not appear to be an arm's length transaction," *id.* at P 336, JA 153, "Transco and its ratepayers received a significant, quantifiable benefit from the agreement between Transco and [Williams]," *id.* at P 335, JA 153.

Finally, the ALJ found North Carolina did "not provide substantive rebuttal to the benefits shown by Transco." *Id.* at P 336, JA 153. Rather, North Carolina's analysis was "fraught with speculative and subjective adjustments to real world contracts." *Id.* Accordingly, while "the Commission should be prepared to protect a pipeline's ratepayers when the jurisdictional assets they are paying for are being used for non-traditional business endeavors, especially without adequate compensation for such use," the ALJ explained that he could "not draw that conclusion with the evidence presented." *Id.*

III. The Challenged Orders

After reviewing the entire record, the Commission affirmed the ALJ's determinations regarding the Transco/Williams agreement. As the Commission explained, North Carolina's claim was premised on its mistaken belief that Transco had agreed to let Williams use Transco's right-of-way to build the fiber optic cable. Order on Initial Decision at P 218, JA 156. In fact, however, Transco's "easements did not include the right to install fiber optic wires. Thus, [Williams]

had to negotiate and pay for its own right of way from landowners. Transco simply agreed not to object to [Williams] seeking its own right of way within Transco's right of way in exchange for the dark fibers." Rehearing Order at P 127, JA 159; *see also* Order on Initial Decision at P 218, JA 156 ("[t]he agreement between Transco and [Williams] was that Transco would not object to [Williams] obtaining its own right of way from landowners along the route of Transco's right of way").

Accordingly, while the agreement was between affiliates, and "may have been an important factor in allowing [Williams] to go forward in the communications business, there [was] no showing that the assets paid for by ratepayers, namely Transco's easement for installing and operating a pipeline, are being used which would warrant a credit." Order on Initial Decision at P 218, JA 156. By contrast, "[f]or its agreement, Transco received the use of fiber optics which it was able to use in its jurisdictional business to upgrade its communications network and thus provide a benefit to its customers." *Id.*

Several parties filed petitions for review of the Order on Initial Decision and the Rehearing Order, but North Carolina's was the only petition that challenged the Commission's determinations regarding the Transco/Williams agreement. The Commission moved to dismiss the other petitions challenging the instant orders (D.C. Cir. Nos. 05-1388 and 05-1390) as incurably premature, because the

petitioners in those cases simultaneously sought Commission rehearing and court review of the same order. The Commission also requested that the Court hold the instant petition in abeyance pending Commission action on the other parties' rehearing requests. On March 10, 2006, this Court granted the Commission's motion to dismiss D.C. Cir. Nos. 05-1388 and 05-1390,[3] and denied the motion to hold the instant petition in abeyance.

SUMMARY OF ARGUMENT

Consistent with this Court's precedent, the ALJ and Commission appropriately determined that, while Transco has the ultimate burden under NGA § 4 to establish that its proposed rates are just and reasonable, Transco was not required to demonstrate in its case in chief that its agreement with Williams was prudent. Rather, once Transco presented its case-in-chief, North Carolina had the burden to come forward with evidence raising a serious doubt about the prudence of the agreement.

North Carolina failed to satisfy that burden. Misconstruing the nature of the agreement, North Carolina proffered evidence that addressed only the value of Transco granting Williams the use of its right of way. As Transco did not grant

[3] Petitions for review were again filed by these parties (D.C. Cir. Nos. 06-1275 and 06-1286) after the Commission issued an order on their rehearing requests. Those petitions are currently pending review in this Court.

Williams the use of its right of way, but agreed only that it would not object to Williams obtaining its own right of way, North Carolina's evidence was inapposite.

Not only did North Carolina fail to raise a serious doubt about the prudence of the agreement, but the evidence indicated that Transco's ratepayers benefited from the agreement. While the agreement did not decrease the value, or Transco's jurisdictional use, of its right of way, it enabled Transco to obtain the use of a fiber optic system, which enhanced Transco's jurisdictional services.

In these circumstances, the ALJ and the Commission appropriately determined that there was no basis to find Transco's agreement with Williams imprudent.

ARGUMENT

I. STANDARD OF REVIEW

The Court reviews FERC orders under the Administrative Procedure Act's arbitrary and capricious standard. *E.g., Sithe/Independence Power Partners v. FERC*, 165 F.3d 944, 948 (D.C. Cir. 1999). Under that standard, the Commission's decision must be reasoned and based upon substantial evidence in the record. For this purpose, the Commission's factual findings are conclusive if supported by substantial evidence. NGA § 19(b), 15 U.S.C. § 717r(b).

In addition, the Court gives substantial deference to the Commission's rate determinations, including its interpretation of relevant contracts, as "matters of rate design . . . are technical and involve policy judgments at the core of FERC's regulatory responsibilities." *Maine Public Utilities Comm'n v. FERC*, 454 F.3d 278, 287 (D.C. Cir. 2006); *Panhandle Eastern Pipe Line Co. v. FERC*, 881 F.2d 1101, 1118 (D.C. Cir. 1989); *Tarpon Transmission Co. v. FERC*, 860 F.2d 439, 441-42 (D.C. Cir. 1988).

II. THE COMMISSION APPROPRIATELY AFFIRMED THE ALJ'S DETERMINATION THAT NORTH CAROLINA HAD NOT RAISED A SERIOUS DOUBT ABOUT THE PRUDENCE OF TRANSCO'S AGREEMENT WITH WILLIAMS

North Carolina contends that the Commission inappropriately placed the burden on it to show that Transco imprudently entered into the agreement with Williams. Br. at 14-18. As the Commission explained, however:

> Since this was [an NGA] section 4 rate increase proceeding, the burden of proof was on Transco to establish that its rates were just and reasonable. . . . While Transco has the ultimate burden under section 4, once Transco submitted its case-in-chief supporting its proposed rates, the interveners were required to come forward with evidence raising a serious doubt about Transco's prudence in not seeking greater compensation from [Williams].[4]

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[4] Citing *U-T Offshore System*, 69 FERC ¶ 61,019 at 61,085 (1994) (the pipeline "bears the initial burden and the shippers' burden only comes into play to rebut [the pipeline's] case-in-chief. This is consistent with the Natural Gas Act."); and *Indiana Municipal Power Agency v. FERC*, 56 F.3d 247, 253 (D.C. Cir. 1995) (a party claiming a pipeline imprudently entered into a contract must "present evidence sufficient to raise serious doubt that a reasonable utility manager, under the same circumstances and acting in good faith, would not have made the same

Rehearing Order at P 126, JA 158. This is wholly consistent with this Court's precedent. *See supra* pp. 3-4 (statutory and regulatory background).

In addition, despite North Carolina's claim to the contrary, Br. at 17-19, the Commission appropriately affirmed the ALJ's determination that North Carolina had not presented evidence raising a serious doubt about Transco's prudence in entering into the agreement with Williams. Rehearing Order at P 126, JA 158-59; Initial Decision at PP 333-36, JA 152-53. Because, in North Carolina's view, Transco granted Williams use of its right of way, North Carolina's evidence addressed the value of that supposed grant.[5] As Transco could not, and did not, grant Williams use of its right of way, however, the evidence North Carolina proffered was inapposite. Rehearing Order at PP 127, JA 159. Transco's right of way "easements did not include the right to install fiber optic wires. Thus, [Williams] had to negotiate and pay for its own right of way from landowners. Transco simply agreed not to object to [Williams] seeking its own right of way

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decision and incurred the same cost").

[5] *See, e.g.*, Br. at 4 ("Ms. Kratvin and Mr. Catlin both testified that the agreement between Transco and its affiliate, [Williams], for free access to Transco's right of way was not an arm's-length transaction and, therefore, that the value of the service provided should be measured by fair-market standards") ; Br. at 15 (North Carolina "introduced mountains of evidence that Transco's agreement to permit its unregulated telecommunication affiliate cost-free access to the pipeline's right-of-way was not a bona fide arm's-length agreement"); Br. at 21 (North Carolina's witness "determine[d] the value of Transco's right-of-way").

within Transco's right of way in exchange for the dark fibers." *Id.*; see also *id.* at P 128, JA 159 ("As the ALJ found, Transco did not give [Williams] its own right-of-way but simply agreed not to object to [Williams] seeking its own right-of-way along the existing pipeline right of way").

North Carolina next complains that "Transco produced no valuation studies of its own" and, therefore, "it is hard to understand how the Commission could find that North Carolina . . . had failed to carry [its] burden." Br. at 17-18 (internal quotation omitted). In accordance with established precedent, however, the Commission, affirming the ALJ, found that, "[s]ince North Carolina and other proponents of a revenue credit did not persuasively challenge Transco's support for its cost-of-service on this issue, [Transco] could rely on its case in chief and was not required to further support its case with specific evidence." Rehearing Order at P 129, JA 159.

Thus, there also is no merit to North Carolina's related contention that substantial evidence did not exist to find that the agreement benefited Transco's customers. Br. at 20-24. As the ALJ and the Commission found, "'it was not 'demonstrated that existing customers have, in any way, specifically funded the arrangement between Transco and [Williams].' Once that finding was made, any additional analysis concerning the revenue credit was unnecessary." Rehearing Order at P 129, JA 160 (quoting Initial Decision at P 333, JA 152) (internal citation

omitted). "[T]he ALJ and the Commission simply observed that, in addition to not being funded by its ratepayers, the arrangement between Transco and [Williams] gave Transco 'a valuable asset, enhancing Transco's jurisdictional services.'" Rehearing Order at P 129, JA 160 (quoting Initial Decision at P 334, JA 152-53).[6]

North Carolina also complains that, because Transco was to provide property rights and land for certain attendant facilities, the Commission incorrectly found "there is no showing that the assets paid for by ratepayers . . . are being used which would warrant a credit." Br. at 19-20 (quoting Order on Initial Decision at P 218, JA 156) (omission by North Carolina). The omitted portion of the quote (", namely Transco's easement for installing and operating a pipeline," Order on Initial Decision at P 218, JA ___), makes clear, however, that the quoted statement was directed only to North Carolina's claims regarding Transco's purported grant to Williams of the use of Transco's right of way. Moreover, "the evidence presented in this case focused only on the value of [Williams'] use of the Transco

[6] Transco's evidence established that agreeing not to oppose Williams obtaining a right of way from landowners "in no way diminished the use or value of the [right of way] in its primary use for Transco." Ex. T-57 at 13, JA 96. Moreover, this agreement enabled Transco "to obtain the use of a fiber optic system which it estimated would cost $24-60 million if it had to obtain its own right of way from landowners since the existing Transco right-of-way did not include the right to lay cable," Rehearing Order at P 129, JA 159-60 (citing Ex. 55 at 7, JA 73).

right-of-way. . . . In fact, North Carolina's own witness stated that neither she nor the Staff witness 'ascribed any specific value to the property rights Transco made available to [Williams] for purposes of constructing the land stations along the fiber optic route.'" Rehearing Order at P 128, JA 159 (quoting Ex. UN-2 at 9, JA 50).

In these circumstances, the Commission appropriately concluded that "[t]here [was] nothing in the record to justify finding that a reasonable utility manager would not have made the same decisions." Rehearing Order at P 127, JA 159. Accordingly, the Commission's affirmance of the ALJ's determinations on this matter should be upheld.

CONCLUSION

For the foregoing reasons, the petition should be denied.

Respectfully submitted,

John S. Moot
General Counsel

Robert Solomon
Solicitor

Beth G. Pacella
Senior Attorney

Federal Energy Regulatory
Commission
888 First Street, N.E.
Washington, D.C. 20426
Phone: 202-502-6048
Fax: 202-273-0901

December 8, 2006

CERTIFICATE OF COMPLIANCE

In accordance with Circuit Rule 28(d)(1), I hereby certify that this brief contains 3,627 words, not including the tables of contents and authorities, the certificate of counsel, this certificate and the addendum.

_____

Beth G. Pacella
Senior Attorney

Federal Energy Regulatory Commission
Washington, DC 20426
Tel: (202) 502-6048
Fax: (202) 273-0901

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Beth G. Pacella
Senior Attorney

Federal Energy Regulatory Commission
Washington, DC 20426
Tel: (202) 502-6048
Fax: (202) 273-0901