

ORAL ARGUMENT HAS NOT BEEN SCHEDULED

**In the United States Court of Appeals
for the District of Columbia Circuit**

Nos. 09-1016 and 09-1024 (consolidated)

INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA, *ET AL.*,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

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

**BRIEF OF RESPONDENT
FEDERAL ENERGY REGULATORY COMMISSION**

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CIRCUIT RULE 28(a)(1) CERTIFICATE

A. Parties and Amici

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

B. Rulings Under Review

1. *Promotion of a More Efficient Capacity Release Market*, Order No. 712, 123 FERC ¶ 61,286 (2008) (Order No. 712), JA 473; and
2. *Promotion of a More Efficient Capacity Release Market*, Order No. 712-A, 125 FERC ¶ 61,216 (2008) (Order No. 712-A), JA 588.

C. Related Cases

This case has not been before this Court or any other court. This case concerns, however, the permanent adoption of a rule regarding shipper capacity releases that was previously adopted by the Commission on a temporary experimental basis, and affirmed by this Court in *Interstate Natural Gas Association of America v. FERC*, 285 F.3d 18 (D.C. Cir. 2002).

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January 20, 2010

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GLOSSARY

FERC or Commission	The Federal Energy Regulatory Commission
INGAA	Petitioner Interstate Natural Gas Association of America
<i>INGAA</i>	<i>Interstate Natural Gas Association of America v. FERC</i> , 285 F.3d 18 (D.C. Cir. 2002)
NGA	Natural Gas Act
Order No. 636	<i>Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol</i> , Order No. 636, FERC Stats. & Regs., Regulations Preambles Jan. 1991 - June 1996 ¶ 30,939, <i>on reh'g</i> , Order No. 636-A, FERC Stats. & Regs., Regulations Preambles Jan. 1991 - June 1996 ¶ 30,950, <i>on reh'g</i> , Order No. 636-B, 61 FERC ¶ 61,272 (1992), <i>on reh'g</i> , 62 FERC ¶ 61,007 (1993), <i>aff'd in part, vacated and remanded in part, United Dist. Cos. v. FERC</i> , 88 F.3d 1105 (D.C. Cir. 1996), <i>order on remand</i> , Order No. 636-C, 78 FERC ¶ 61,186 (1997)
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Order No. 712	<i>Promotion of a More Efficient Capacity Release Market</i> , Order No. 712, 123 FERC ¶ 61,286 (2008), JA 473

Order No. 712-A	<i>Promotion of a More Efficient Capacity Release Market,</i> Order No. 712-A, 125 FERC ¶ 61,216 (2008), JA 588
Pipelines	Petitioners Interstate Natural Gas Association of America and Spectra Energy Transmission, LLC and Spectra Energy Partners, LP
Proposed Rule	<i>Promotion of a More Efficient Capacity Release Market,</i> 121 FERC ¶ 61,170 (2007), JA 310
Spectra	Petitioners Spectra Energy Transmission, LLC and Spectra Energy Partners, LP

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

**BRIEF OF RESPONDENT
FEDERAL ENERGY REGULATORY COMMISSION**

STATEMENT OF THE ISSUE

Whether the Federal Energy Regulatory Commission (FERC or Commission), while lifting the cost-based price ceiling on shipper releases in the short-term capacity market to improve allocative efficiency and shipper pricing flexibility, reasonably declined also to lift the cost-based recourse rate requirement for pipeline short-term capacity sales, where the Commission could not find that the short-term capacity market was sufficiently competitive on all pipelines and

pipeline segments to assure just and reasonable rates in the absence of the recourse rate.

STATUTES AND REGULATIONS

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

INTRODUCTION

In *Interstate Natural Gas Association of America v. FERC*, 285 F.3d 18, 30-34 (D.C. Cir. 2002) (*INGAA*), this Court affirmed a determination by the Commission to lift temporarily – as part of a two-year experiment – the price ceiling on shipper short-term (less than one year) capacity releases, to permit short-term capacity release prices to rise to market-clearing levels. The Court also affirmed the Commission’s determination to retain the cost-based recourse rate requirement for pipeline short-term capacity sales, finding that the Commission reasonably distinguished between pipelines and shippers based upon the likelihood of their wielding market power. *Id.* at 35-36.

In 2006, shippers petitioned for a permanent lifting of the price ceiling on shipper short-term capacity releases, on the ground that pricing flexibility for shipper releases would permit shippers to better compete with pipeline pricing flexibility, particularly pipelines’ ability to enter into negotiated rate agreements with shippers that may exceed the pipelines’ maximum rate (so long as the pipeline

cost-based recourse rate remains available as an alternative rate). Pipelines responded that the price ceiling should be removed from the entire short-term capacity marketplace, including pipeline capacity sales, to avoid discrimination against pipeline sales and the creation of a bifurcated market.

In the orders challenged in this appeal -- *Promotion of a More Efficient Capacity Release Market*, Order No. 712, 123 FERC ¶ 61,286, JA 473 (Order No. 712), *on reh'g*, Order No. 712-A, 125 FERC ¶ 61,216 (2008), JA 588 (Order No. 712-A) -- the Commission lifted the price ceiling on short-term shipper releases. However, as in *INGAA*, the Commission did not lift the pipeline cost-based recourse rate requirement. The Commission could not find that the short-term market was sufficiently competitive, in the absence of pipeline recourse rates, to assure just and reasonable rates. Retention of the pipeline cost-based recourse rate was necessary to protect against the potential exercise of market power in the short-term capacity market.

STATEMENT OF FACTS

I. STATUTORY AND REGULATORY BACKGROUND

“[T]he basic premise of the [Natural Gas Act] is the understanding that natural gas pipeline transportation is generally a natural monopoly so that without regulation the rates of pipeline companies would exceed competitive rates, *i.e.*, ones approximating costs.” *INGAA*, 285 F.3d at 30 (citations omitted).

Traditionally, FERC authorized pipelines to transport natural gas by issuing a certificate of public convenience and necessity for each individual transaction under § 7 of the Natural Gas Act (NGA), 15 U.S.C. § 717f. *Columbia Gas Transmission Corp. v. FERC*, 848 F.2d 250, 252 (D.C. Cir. 1988). Under this authority, pipelines generally performed both a merchant and transportation function, “bundling” into one transaction price the natural gas commodity and the transportation service bringing that gas to the customer. *NorAm Gas Transmission Co. v. FERC*, 148 F.3d 1158, 1160 (D.C. Cir. 1998). In these circumstances, interstate pipelines retained market power in gas transportation and generally declined to transport gas in competition with their own sales. *Columbia Gas*, 848 F.2d at 252.

In Order No. 636,¹ to address distortions in the sales market caused by pipeline monopoly power over transportation, the Commission ordered the mandatory unbundling of pipelines’ sales and transportation services. *United Distribution Cos. v. FERC*, 88 F.3d 1105, 1126 (D.C. Cir. 1996). Because no

¹ *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, Order No. 636, FERC Stats. & Regs., Regulations Preambles Jan. 1991 - June 1996 ¶ 30,939, *on reh’g*, Order No. 636-A, FERC Stats. & Regs., Regulations Preambles Jan. 1991 - June 1996 ¶ 30,950, *on reh’g*, Order No. 636-B, 61 FERC ¶ 61,272 (1992), *on reh’g*, 62 FERC ¶ 61,007 (1993), *aff’d in part, vacated and remanded in part*, *United Dist. Cos. v. FERC*, 88 F.3d 1105 (D.C. Cir. 1996), *order on remand*, Order No. 636-C, 78 FERC ¶ 61,186 (1997).

seller of natural gas had market power over the commodity itself, the Commission issued blanket sales certificates to pipelines that allowed them to sell unbundled natural gas at market-based rates. Order No. 636 at 30,439-40. However, because pipelines continued to possess market power over transportation, the Commission continued cost-based regulation of pipeline transportation rates. *United Distribution Cos.*, 88 F.3d at 1126.

In order to create competition for pipeline transportation capacity, the Commission instituted a shipper capacity release program. *United Distribution Cos.*, 88 F.3d at 1149; Order No. 636 at 30,418. Much of the nation's interstate pipeline capacity was reserved for firm transportation, and those transportation rights largely were not being used. *United Distribution Cos.*, 88 F.3d at 1149; Order No. 636 at 30,406. The Commission sought to develop a secondary transportation market to permit holders of unused firm capacity rights to resell them in competition with capacity offered by the pipeline. *United Distribution Cos.*, 88 F.3d at 1149. Because the record compiled in the Order No. 636 proceeding did not show that the market for released capacity was competitive, the Commission imposed a rate ceiling on shipper releases, derived from the pipeline's

maximum cost-of-service tariff rate. Order No. 636 at 30,418; Order No. 636-A at 30,560; Order No. 637² at 31,270-71.

In 2000, in Order No. 637, the Commission conducted a two-year experimental program to provide more flexibility in the capacity release market by removing the rate ceiling for short-term (less than one year) shipper capacity release transactions. The record in Order No. 637, including data from the bundled sales market,³ showed that competition in the capacity release markets had successfully, on average, kept the rates for released capacity below the maximum rates during both peak and off-peak periods. Order No. 637-A at 31,563. This

² *Regulation of Short-Term Natural Gas Transportation Services and Regulation of Interstate Natural Gas Transportation Services*, Order No. 637, FERC Stats. & Regs. ¶ 31,091, *clarified*, Order No. 637-A, FERC Stats. & Regs. ¶ 31,099, *reh'g denied*, Order No. 637-B, 92 FERC ¶ 61,062 (2000), *aff'd in part and remanded in part sub nom., Interstate Natural Gas Ass'n of America v. FERC*, 285 F.3d 18 (D.C. Cir. 2002), *order on remand*, 101 FERC ¶ 61,127 (2002), *order on reh'g*, 106 FERC ¶ 61,088 (2004), *aff'd sub nom., American Gas Ass'n v. FERC*, 428 F.3d 255 (D.C. Cir. 2005).

³ Although pipelines are precluded from engaging in bundled transactions, shippers may bundle the sale of gas with transportation service. For such bundled transactions, the maximum rate regulation applicable to purely transportation transactions does not apply. Under Congress' deregulation of "first sales" and the Commission's blanket sales certificate rules, the price of the gas commodity, and of bundled sales including the gas commodity, are not subject to rate regulation or price caps. Consequently, a comparison of the price of bundled sales at the wellhead and the price downstream reflects the value of the transportation to the delivered market. Order No. 637 at 31,271. The difference between the price of gas at the upstream production area and the price of gas at a downstream market is referred to as the "basis differential," and reflects the implicit value of the transportation from the production area to the downstream market.

demonstrated that competition significantly limited releasing shippers' ability to exercise market power during peak periods, even without a price ceiling. *Id.* The only time rates increased above the cost-based maximum ceiling rate was during peak demand periods, when higher prices were needed to effectively allocate capacity. *Id.*

Based on these findings, the Commission determined that the rate ceiling on shipper releases should be removed. Order No. 637-A at 31,550. The maximum rate cap on capacity release transactions inhibits the efficient allocation of capacity because it prevents capacity from going to those that value it the most. Order No. 637 at 31,263; Order No. 637-A at 31,554. Protection against the exercise of market power in the short-term capacity release market could be achieved in other ways, including competition, improved reporting, monitoring and complaint procedures, and the Commission's ongoing regulation of pipeline capacity. Order No. 637-A at 31,550. The Commission limited the waiver of the rate cap to two years to provide an opportunity to assess the results of the experiment. Order No. 637 at 31,279.

The Commission nevertheless maintained the rate ceiling for pipeline capacity releases because the requirements that pipelines must offer all capacity into the market, and must maintain a cost-based recourse rate as an alternative to negotiated rates, prevent the exercise of market power by both pipeline and

releasing shipper. Order No. 637-A at 31,564. Further, pipelines already possessed avenues for lifting the price ceiling on their short-term services through implementing an auction process or applying for market-based rates. *Id.* at 31,572.

INGAA upheld the Order No. 637 shipper release experiment. *INGAA*, 285 F.3d at 35. The Court found that the Commission's "light handed" approach to the regulation of capacity release prices was justified given the safeguards that the Commission had imposed. *Id.* at 33. The Commission had made a substantial record showing that market rates for shipper releases would not materially exceed the "zone of reasonableness." *Id.* The price spikes in the capacity market were consistent with competition, reflecting scarcity of supply rather than monopoly power, and, outside of such price spikes, the rates were well below the estimated regulated price. *Id.*

INGAA also affirmed the Commission's decision to retain the price ceilings on pipeline capacity releases. *Id.* at 35-36. The Court found that the Commission's distinction between the pipelines and the releasing shippers was reasonable based upon their differing abilities to exercise market power in the capacity market. *Id.* Further, pipelines do have options for switching to market rates, such as demonstrating that there is enough competition in the short-term market to preclude market power. *Id.* at 35.

II. THE ORDER NO. 712 RULEMAKING

A. The Commencement of the Rulemaking

In August 2006, two public utility shippers filed a petition for rulemaking in FERC docket no. RM06-21, requesting that the Commission remove the maximum rate cap on shipper capacity release transactions, to provide shippers the same ability as pipelines to exceed the maximum recourse rate. *See* R. 134, JA 1-14. Under the Commission's negotiated rate policy,⁴ pipelines are permitted to negotiate rates that vary from -- and may exceed -- the cost-of-service tariff rate as long as the pipeline also makes available to the shipper an alternative cost-of-service recourse rate. In particular, the Commission permits interstate pipelines to enter into negotiated rate agreements based on "basis differentials," (*see* n.3 *supra*), *i.e.*, the basis spread between two natural gas trading points, such as a supply basin and a city gate delivery point. *Natural Gas Pipeline Negotiated Rate Policies and Practices*, 114 FERC ¶ 61,042, *on reh'g*, 114 FERC ¶ 61,304 (2006). Thus, while pipelines could use their negotiated rate authority to sell their own capacity at market-based rates exceeding the maximum rate, including the use of basis differential pricing, releasing shipper market-based rate transactions were

⁴ *See Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines, Regulation of Negotiated Transportation Services*, 74 FERC ¶ 61,076, *order on clarification*, 74 FERC ¶ 61,194, *order on reh'g*, 75 FERC ¶ 61,024 (1996), *petitions for review denied*, *Burlington Resources Oil & Gas Co. v. FERC*, 172 F.3d 918 (D.C. Cir. 1998).

capped at the maximum cost-based rate. *Promotion of a More Efficient Capacity Release Market*, Notice of Proposed Rulemaking, 121 FERC ¶ 61,170 P 24 (2007) (Proposed Rule).

On January 3, 2007, the Commission requested comments on whether changes in any of its capacity release policies would improve the efficiency of the natural gas market, including whether the Commission should eliminate the price ceilings on capacity releases. *Pacific Gas & Electric Co.*, 118 FERC ¶ 61,005 (2007).

Commenting shippers and pipelines both advocated lifting the price ceiling on short-term capacity releases, subject to different conditions. Proposed Rule P 19. The shippers favored lifting the ceiling only if it would still apply to the pipeline's capacity sales because, among other things, the pipelines have negotiated rate authority that is not available to releasing shippers. *Id.* The pipelines advocated removal of the cap only if the cap was removed from the entire capacity marketplace; otherwise, they argued, it would create a bifurcated market. *Id.*

Based upon its review of the petitions, comments and available data, the Commission proposed to lift the price ceiling for shipper short-term capacity release transactions. Proposed Rule P 23. Lifting the price ceiling would produce just and reasonable rates, would enable releasing shippers to compete with pipeline

negotiated rate offerings, and would result in more efficient utilization of capacity by permitting those who value the capacity most highly to obtain it. *Id.* PP 25-29. The Commission did not propose to remove the price ceiling for primary pipeline capacity, however, finding that retention of the price ceiling for short-term pipeline capacity sales was necessary to protect against the exercise of market power by the pipelines, and also by releasing shippers. *Id.* PP 40, 48-49, JA 315, 317.

Over 60 entities from all segments of the natural gas industry filed comments on the Proposed Rule, and the vast majority generally agreed with removing the cap on short-term shipper releases. Order No. 712 P 19, JA 480. Many of the local distribution companies, marketers, producers and end-users also supported retaining the price cap on primary pipeline capacity, as it provides a valuable safeguard against the exercise of market power in the short-term capacity release market. *Id.*

B. The Challenged Orders

1. Order No. 712

In the Order No. 712 Final Rule, the Commission removed the price ceiling on shipper short-term capacity releases. Order No. 712 P 25, JA 482. Eliminating the ceiling would improve shipper options and market efficiency, particularly during peak periods, by allowing the prices of short-term capacity release

transactions to reflect short-term variations in the market value of that capacity. *Id.* P 30, JA 483.

The rates resulting from removal of the price cap would be just and reasonable. *Id.* P 31, JA 483. The data collected over many years shows that the value of short term capacity only exceeds the price ceiling when capacity is scarce, as would be expected under competitive conditions. *Id.* Further, the maximum recourse rate cap on pipeline services protects against the exercise of market power in the capacity release market. *Id.* Pipelines cannot exercise market power where the customer can opt for the cost-based recourse rate. *Id.* P 48, JA 490. Likewise, a releasing shipper's attempt to exercise market power by withholding its firm capacity will be undermined because pipelines are required to sell unused capacity as interruptible capacity to a shipper willing to pay the maximum rate. *Id.* (citing Order No. 637 at 31,282).

The Commission declined to remove the price ceiling for short-term pipeline capacity sales. *Id.* P 81, JA 497. Lifting the ceiling would negate the recourse rate protection against the exercise of pipeline and releasing shipper market power. *Id.* P 82, JA 497. Further pipelines, as the principal holders of capacity, have a greater ability than releasing shippers to exercise market power by withholding capacity and not constructing facilities. *Id.* PP 84, 85, 89, JA 497-99. With cost-of-service rate ceilings, pipelines have a greater incentive to build, since the pipeline can only

increase revenues and profits by investing in additional facilities to serve increased demand. *Id.* P 85, JA 498.

Also, pipelines already have significant pricing discretion: they can enter into negotiated rate transactions above the maximum rate, they can qualify for market-based rates by demonstrating that they lack or adequately have mitigated market power, or they can propose seasonal rates. Order No. 712 P 86, JA 498. The Commission lifted the rate ceiling on shipper releases to give shippers some of the same flexibility enjoyed by the pipelines. *Id.* While the flexibility offered to pipelines and releasing shippers is not identical, retention of the recourse rate is necessary to provide an effective check on both entities. *Id.* P 98, JA 501. The Commission sought to provide both pipelines and shippers with reasonably comparable flexibility consistent with the differences between these entities and the need to provide protection against market power. *Id.*

The pipelines contended that retaining the rate cap was unnecessary because the secondary market was competitive, and shippers collectively control more capacity than pipelines. However, the Commission could not find that competition in the secondary market would adequately protect against market power. *Id.* P 88, JA 498. While the data indicated that the short-term secondary market was competitive in general, concerns remained about the ability of pipelines to exercise market power in short-term transactions on at least some segments of their

systems. *Id.* P 102, JA 501. Consequently, a blanket removal of the price cap on all such pipeline transactions, without consideration of specific circumstances on individual pipeline systems, was unjustified. *Id.*

Although firm shippers may, as a group, control more capacity than the pipelines, this does not change the relative market-power analysis; pipeline-controlled capacity is available for sale during peak periods whereas shipper capacity may not be available, as much of it is required to serve retail load. *Id.* P 94, JA 500 (citing *INGAA*, 285 F.3d at 24). More importantly, because pipelines are the primary parties constructing additional capacity, it is crucial that their incentive to build is not diluted by the ability to earn scarcity rents in the short-term market. *Id.*

The Commission also rejected arguments based on the “bifurcation” of the market at times of scarcity, due to the artificially low capped price of pipeline capacity. *Id.* P 103, JA 502. There would be no bifurcation as long as effective arbitrage exists, as any shipper that acquires pipeline capacity at the lower capped rate would have an incentive to resell that capacity to another shipper who would pay the higher rate, thus ensuring that the market clearing price will reflect all relevant demand. *Id.* P 104, JA 502. Even where arbitrage is not fully effective, the Commission found it better to err on the side of enhanced protection against

market power. *Id.* P 108, JA 503. *INGAA* affirmed this same policy choice in Order No. 637. *Id.* (citing *INGAA*, 285 F.3d at 33).

2. Order No. 712-A

No party sought rehearing of the Commission's determination to remove the price ceiling for shipper capacity release transactions. Order No. 712-A P 12, JA 591. The only major issue related to the price ceiling raised on rehearing was the pipelines' contention that the Commission erred by not also removing the recourse rate requirement for pipeline short-term services. *Id.*

The Commission denied rehearing, continuing to find that maintenance of the recourse rate ceilings for pipeline short-term transactions is necessary to protect against the exercise of market power by pipelines and releasing shippers. *Id.* P 16, JA 591. While capacity release prices generally suggested a competitive market, the Commission did not find that the entire secondary market was competitive. *Id.* P 17, JA 592. On some portions of the pipeline grid, little effective competition may exist. *Id.* Precisely because the Commission did not make such a competitive market finding, the Commission continued to insist on the maintenance of the pipelines' cost-based recourse rate as protection against the exercise of market power. *Id.* PP 17, 23, 25, 30, JA 592, 593, 595.

Moreover, the implications of removing the price ceiling for pipeline capacity are more serious than for shipper capacity release because pipelines, due

in part to their economies of scale, can exercise market power over pipeline capacity, particularly with respect to the construction of long-term capacity. *Id.* P 18, JA 592. While the pipelines asserted that their construction decisions would not be influenced by prices in the short-term market, firms with market power, like pipelines, will construct less capacity than competitive firms because doing so results in higher prices and profits. *Id.* PP 32-33, JA 595.

The Commission also disagreed that its determination will preclude pipelines from recovering their cost-of-service if they must discount capacity prices during off-peak periods to meet competition and cannot charge above the maximum recourse rate during peak periods. *Id.* PP 39, 44, JA 597-98. Under longstanding Commission policy, pipelines may adjust the volumes used to design their maximum recourse rates, so that they can recover their full cost-of-service even when competition requires them to offer discounts. *Id.* P 45, JA 599. Because pipelines are able to recover their cost-of-service, maintaining the recourse rate to ensure continued protection of customers does not result in losses to pipelines. *Id.* P 49, JA 599.

The Commission also rejected arguments that its policy creates a bifurcated market that will compromise allocative efficiency. *Id.* P 50, JA 599. If effective arbitrage exists, then a bifurcated market will not be created, and the Commission has attempted to reduce the costs of arbitrage so that a seriously bifurcated market

will not occur. *Id.* P 51, JA 599. While in limited situations there may be insufficient arbitrage to prevent a bifurcated market, maintenance of the recourse rate is necessary precisely because various parts of the interstate grid may not be competitive. *Id.* PP 52-53, JA 600. No amount of arbitrage will ensure a competitive market if a single shipper controls a large portion of the pipeline capacity either on the pipeline as a whole or in any individual market. *Id.*

On rehearing Spectra Energy Transmission, LLC and Spectra Energy Partners, LP (Spectra) offered two alternatives that purportedly would mitigate any harm from removing the price ceiling from pipeline services: (i) allowing pipelines to auction short-term capacity; or (ii) removing the price cap on short-term firm services but retaining it on short-term interruptible services. *Id.* P 54, JA 600.

The Commission rejected Spectra's proposal to lift the ceiling on short-term firm pipeline service and retain it only on interruptible service, finding that Spectra offered no details about how its proposal would work. Order No. 712-A P 56 n.63, JA 600. For example, Spectra did not explain how short-term firm capacity would be differentiated from long-term firm capacity (since the same capacity can be purchased for short or long-term use), nor how bidding on short-term and long-term capacity would be evaluated to ensure that the pipeline was not favoring short-term bids over long-term bids to evade the long-term price cap. *Id.*

As to Spectra's auction proposal -- made for the first time in Spectra's request for rehearing -- Order No. 637 delineated the necessary elements of such a proposal, in particular the requirement that the proposal protect against the exercise of market power by the pipeline. *Id.* P 55, JA 600 (quoting Order No. 637 at 31,295). Order No. 637 also set out basic principles for designing an auction to ensure that it would be transparent, verifiable, and non-discriminatory. *Id.* (citing Order No. 637 at 31,296). Spectra's auction proposal failed to meet these requirements. *Id.* Further, other parties had no opportunity to comment on the details of Spectra's proposal, and the Commission, therefore, did not have a sufficient record to rule on a generic basis on the proposal in this rulemaking. *Id.*

SUMMARY OF ARGUMENT

For the second time, this Court is presented with a challenge to the Commission's decision to eliminate price ceilings on shipper short-term capacity releases but not on pipeline short-term capacity sales. *See INGAA*, 285 F.3d at 30-36. And, for the second time -- this time based on the Commission's evaluation of an even more extensive record, justifying movement from a temporary experiment to a rule -- the Court should affirm the Commission's reasonable distinction between pipeline and shipper capacity sales. Here, as in *INGAA*, the Commission could not find that the short-term capacity market was sufficiently competitive, in the absence of pipeline recourse rates, to assure just and reasonable rates.

Retention of the recourse rate was necessary to protect against the potential exercise of market power by pipelines and releasing shippers. Pipelines cannot exercise market power where the customer can opt for the cost-based recourse rate. Likewise, a releasing shipper cannot exercise market power by withholding capacity where pipelines must sell any unused capacity on an interruptible basis to a shipper willing to pay the cost-based maximum tariff rate.

Petitioners (Interstate Natural Gas Association of America (INGAA) and Spectra (collectively Pipelines)), fail to demonstrate that the Commission's determination was unreasonable. Pipelines primarily assert that -- because the Commission found that the secondary market would produce competitive rates in

the absence of the shipper rate cap -- the Commission was also compelled to remove the recourse rate requirement from pipeline short-term capacity sales. The competitive finding was made, however, in the current market where the pipeline recourse rate constrains the ability of both pipelines and releasing shippers to exercise market power. The Commission did not find that all pipelines are competitive on all segments such that the protections of the recourse rate could be eliminated. To the contrary, in the absence of recourse rate protection, the Commission found there may be opportunities for the exercise of market power on certain pipelines or segments of pipelines. Thus, the Commission reasonably maintained the cost-based recourse rate requirement.

The Commission's retention of the pipeline cost-based recourse rate does not prevent pipelines from recovering their cost-of-service. Pipelines continue to recover their cost-of-service while providing the recourse rate alternative; in particular, pipelines can obtain a discount adjustment in individual rate cases if they are required to discount rates to respond to competition. Nor does Order No. 712 give shippers an unfair competitive advantage. The price ceiling on shipper releases was lifted to provide shippers with pricing flexibility to exceed the maximum rate similar to the negotiated rate authority already enjoyed by pipelines. Although pipeline options for exceeding the cost-based recourse rate -- obtaining an individual grant of market-based rates, negotiated rates, or seasonal rates -- are

not the same as the negotiating authority given releasing shippers under Order No. 712, releasing shippers and pipelines are not similarly situated. The Commission intended to provide both groups with a measure of pricing flexibility, consistent with the need to protect against the potential exercise of market power in the short-term capacity market by retaining the pipeline recourse rate.

Pipelines' arguments regarding their proposed alternatives are likewise unavailing. The Court is jurisdictionally barred from considering the auction alternative, which was proposed for the first time in Spectra's petition for rehearing of Order No. 712, because rehearing was never sought of the Commission's rejection of that alternative in Order No. 712-A. Further, both proposed alternatives (the auction alternative and the alternative of retaining the recourse rate only for interruptible service) failed to specify how pipeline market power would be sufficiently constrained under the proposals.

ARGUMENT

I. STANDARD OF REVIEW

The Court reviews FERC orders under the Administrative Procedure Act's arbitrary and capricious standard. *See, e.g., Sithe/Independence Power Partners v. FERC*, 165 F.3d 944, 948 (D.C. Cir. 1999). The relevant inquiry is whether the agency has “examine[d] the relevant data and articulate[d] a rational connection between the facts found and the choice made.” *Motor Vehicle Manufacturers Ass’n v. State Farm Mutual Auto. Ins. Co.*, 463 U.S. 29, 43 (1983).

“The statutory requirement that rates be ‘just and reasonable’ is obviously incapable of precise judicial definition, and [the Court] afford[s] great deference to the Commission in its rate decisions.” *Morgan Stanley Capital Group Inc. v. Pub. Util. Dist. No. 1*, 128 S. Ct. 2733, 2738 (2008). “Because [i]ssues of rate design are fairly technical, and, insofar as they are not technical, involve policy judgments that lie at the core of the regulatory mission, [the court’s] review of whether a particular rate design is just and reasonable is highly deferential.” *Northern States Power Co. v. FERC*, 30 F.3d 177, 180 (D.C. Cir. 1994) (internal quotation marks and citations omitted). *See also Electricity Consumers Res. Council v. FERC*, 407 F.3d 1232, 1236 (D.C. Cir. 2005) (same).

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 Municipal Power Agency v. FERC*, 315 F.3d 362, 365 (D.C. Cir. 2003) (quoting *FPL Energy Me. Hydro LLC v. FERC*, 287 F.3d 1151, 1160 (D.C. Cir. 2002)). “When the record would support more than one outcome,” the court upholds the Commission’s order because the relevant question “is not whether record evidence supports [the petitioner’s desired outcome], but whether it supports FERC’s.” *Maine Pub. Utils. Comm’n v. FERC*, 520 F.3d 464, 470 (D.C. Cir. 2008) (alteration in original, citation omitted) (*certiorari* granted in S. Ct. No. 08-674 on separate issue). See *Petal Gas Storage, L.L.C. v. FERC*, 496 F.3d 695, 703 (D.C. Cir. 2007) (Commission is not required to choose the best solution, only a reasonable one); *ExxonMobil Oil Corp. v. FERC*, 487 F.3d 945, 955 (D.C. Cir. 2007) (FERC need not adopt the best possible policy as long as agency acts within the scope of its discretion and reasonably explains its actions).

II. THE COMMISSION REASONABLY DECLINED TO LIFT THE PIPELINE RECOURSE RATE REQUIREMENT.

A. The Commission Could Not Find Sufficient Competition On All Parts Of All Pipelines To Assure Just And Reasonable Rates Without The Recourse Rate Requirement.

In *INGAA*, 285 F.3d at 32-33, this Court affirmed the Commission’s decision to, on a temporary basis, lift the price ceiling on shipper short-term capacity releases while retaining the pipeline cost-based recourse rate requirement.

The Court found that the Commission developed a substantial record for the proposition that the rates in the secondary market would remain competitive, so long as potential market power was restrained by the cost-based pipeline recourse rate and the requirement that pipelines sell all available capacity to a shipper willing to pay the maximum rate. *Id.* The Court also affirmed the Commission's decision to retain the cost-based recourse rate requirement for pipelines, finding that the Commission reasonably distinguished between pipelines and shippers, "based on the probable likelihood of wielding market power." *Id.* at 36.

In Order No. 712, the Commission implemented the experimental determination at issue in *INGAA* on a permanent basis, lifting the price cap on shipper releases but retaining the cost-based pipeline recourse rate. As in *INGAA*, the Commission lifted the price ceiling on shipper capacity releases, based upon its finding that competition in the short-term capacity release market, *coupled with* the continuing requirement that pipelines maintain a cost-based recourse rate for primary pipeline capacity, would assure that rates would stay within the zone of reasonableness required under the NGA. Order No. 712 PP 38, 39, 48, JA 485, 490 (citing *INGAA*, 285 F.3d at 31; *Farmers Union Central Exchange v. FERC*, 734 F.2d 1486, 1502 (D.C. Cir. 1984)); Order No. 712-A P 23, JA 593. Pipelines cannot exercise market power where the customer can opt for the cost-based recourse rate. Order No. 712 P 48, JA 490. Likewise, a releasing shipper cannot

withhold firm capacity where pipelines are required to sell unused capacity as interruptible capacity to a shipper willing to pay the maximum rate. Order No. 712 PP 48-49, JA 490 (citing Order No. 637 at 31,282; *INGAA*, 285 F.3d at 32).

As in *INGAA*, the Commission retained the cost-based recourse rate requirement for pipelines, because it found that just and reasonable rates in the short-term capacity market could not be assured in the absence of the pipeline recourse rate requirement. Order No. 712 P 88, JA 498; Order No. 712-A PP 17, 25, JA 592-93. While the short-term secondary capacity market was competitive in general, the Commission could not find competitive conditions in the sale of short-term capacity on all segments of every pipeline. Order No. 712 PP 61, 88, JA 493, 498; Order No. 712-A PP 17, 25, 27, JA 592-94. *See* Order No. 712 P 102, JA 501 (“there are sufficient concerns about the ability of pipelines to exercise market power in short-term transactions on at least some segments of their systems, that a blanket removal of the price cap on all such pipeline transactions in this rulemaking proceeding, without consideration of specific circumstances on individual pipeline systems, would be inappropriate”). Thus, the Commission could not make a finding on a generic basis in this rulemaking proceeding that all pipelines are competitive. Order No. 712 P 91, JA 499; Order No. 712-A P 26, JA 594.

Precisely because the Commission did not make such a competitive market finding, the Commission continued to require maintenance of the pipeline recourse rate. Order No. 712 P 88, JA 498; Order No. 712-A PP 17, 25, JA 592-93. “[T]he basic premise of the NGA is the understanding that natural gas pipeline transportation is generally a natural monopoly,” so that “without regulation the rates of pipeline companies would exceed competitive rates, *i.e.*, ones approximating costs.” *INGAA*, 285 F.3d at 30 (citing *United Distribution Cos.*, 88 F.3d at 1122; *Elizabethtown Gas Co. v. FERC*, 10 F.3d 866, 870 (D.C. Cir. 1993)). Given this natural monopoly power over transportation, the Commission can “dispens[e] with cost-based rate ceilings presumptively intended by Congress as a remedy,” and impose instead more relaxed (*i.e.* “light-handed”) regulation, only if the Commission can show that the resulting rates may be expected to fall within a “zone of reasonableness.” *INGAA*, 285 F.3d at 31. *See* Order No. 712 P 38, JA 485 (same). Here, the Commission could not “relax the recourse rate protection given that the entirety of the market has not been shown to be sufficiently competitive.” Order No. 712-A P 46, JA 599.

In Pipelines’ view, the Commission’s finding that the short-term market is generally competitive compels the conclusion that no entity in the market has market power, and therefore there is no need or basis for maintaining the pipeline recourse rate requirement. Br. 25-28. Pipelines also maintain that FERC

“attempted on rehearing to move away from its finding that the market was generally competitive in order to bolster its position on pipeline rate caps.” Br. 32. To the contrary, throughout Order No. 712, the Commission emphasized that the pipeline recourse rate was an essential part of its determination to remove the price ceiling for released shipper capacity only. Order No. 712 PP 31, 48, 61, 86, 102, JA 483, 490, 493, 498, 501. Indeed, as the Commission noted, most of the commenters that supported removal of the rate ceiling for capacity release transactions did so only if the pipeline recourse rate was maintained as a valuable safeguard to protect against market power. Order No. 712 P 19, JA 480.

The Commission also emphasized that the data on which it relied “reflects the competitive nature of the short term capacity release market and the safeguards that the Commission employs in the instant Final Rule to mitigate any residual market power.” Order No. 712 P 62, JA 493. In other words, the data relied upon by the Commission demonstrating competition in the capacity release market was derived from a market in which pipeline cost-based recourse rates provided protection from the exercise of market power by both pipelines and releasing shippers. Both the empirical data from Order No 637, Br. 25, and the basis differentials for the twelve months ending in July of 2007, Br. 26, were derived from a market *with* a recourse rate requirement. The Commission did not at any time find that competition alone would assure just and reasonable rates in the

capacity release market in the *absence* of a recourse rate requirement. Order No. 712 P 48, JA 490; Order No. 712-A P 53, JA 600. Rather, it was the combination of competition with the maintenance of the pipeline recourse rate that would assure just and reasonable rates. Order No. 712 P 48, JA 490; Order No. 712-A P 53, JA 600.

B. The Commission Made Ample Findings On The Record To Support Its Market Power Concerns.

Pipelines assert that no record evidence supports the Commission's concern that opportunities may remain to assert market power in the short-term capacity market. Br. 27-33. To the contrary, the Commission made ample findings on the record to support its determination that there are significant market power concerns that warranted retaining the pipeline recourse rate.

1. Pipelines Can Withhold Capacity By Failing To Construct Needed Infrastructure.

Unlike shippers who cannot control the total amount of capacity, pipelines can affect the total amount of capacity by determining whether to construct additional capacity. Order No. 712-A PP 30-31, JA 595; Order No. 712 P 84, JA 497 (citing *INGAA*, 285 F.3d at 35). Thus, pipelines, in part due to their economies of scale, can exercise market power over pipeline capacity, particularly with regard to the construction of long-term capacity. Order No. 712 PP 67, 85, JA 494, 498; Order No. 712-A P 18, JA 592. If a pipeline can extract extra-

competitive prices in the short-term market, it has an incentive not to construct additional needed capacity because of the excess revenues it can garner in the short-term market. Order No. 712 PP 67, 85, 89, JA 494, 498, 499; Order No. 712-A PP 18, 19, 35, JA 592, 596.

Pipelines assert that long-term construction decisions are unaffected by short-term prices. Br. 30 (citing Affidavit of Edward C. Gallick, R. 43 P 101, JA 436). Although the Commission did not respond to the Gallick affidavit by name, Br. 14-15, the Commission nevertheless fully explained its disagreement with the contention that pipeline construction decisions are unrelated to prices in the short-term market. Where the Commission fully addressed the underlying argument, the failure to specifically reference the Gallick Affidavit is immaterial. *See, e.g., National Association of Regulatory Utility Commissioners v. FERC*, 475 F.3d 1277, 1285 (D.C. Cir. 2007) (rejecting arguments that FERC's factual conclusions were unsupported because FERC failed to address an affidavit directly, where FERC responded to the issue raised in the affidavit); *International Ladies' Garment Workers' Union v. Donovan*, 722 F.2d 795, 818 (D.C. Cir. 1983) (agency need not respond to every comment, but must respond to significant issues raised by the comments).

Releases at prices above the maximum rate indicate that pipeline capacity is constrained and demonstrate that constructing additional capacity could be

profitable. Order No. 712 PP 67, 85, JA 494, 498. Thus, under competitive conditions, accurate price signals concerning the value of capacity will promote construction of needed capacity. Order No. 712 P 67, JA 494. *See INGAA*, 285 F.3d at 33 (“if pipelines should observe high prices in the secondary market, they will -- despite their capped rates -- often have adequate incentives to add capacity, which they can do even in the relatively short-term by adding compression”); Order No. 637-A at 31,566 (“if short-term prices rise frequently enough to make the construction of additional pipeline capacity profitable, the pipeline will have the incentive to build that capacity”); *Blumenthal v. FERC*, 552 F.3d 875, 883 (D.C. Cir. 2009) (market rate spikes during times of scarcity “also serve a critical signaling function: encouraging new development that will increase supply”).

Petitioner INGAA itself argued that high prices send the proper price signals as to whether new construction is needed. Order No. 712 P 90, JA 499; Order No. 712-A PP 36-37, JA 596-97; INGAA Rulemaking Comment at 16, R. 66, JA 344.

If prices are “exacerbated” by scarcity, shippers have every incentive to go to the pipeline and support economically efficient construction to rectify the shortage. Order No. 712 P 67, JA 494. For example, shippers that require capacity during the peak winter heating season on constrained pipelines cannot risk waiting to contract for capacity until the capacity is needed, and therefore they enter into long-term (or at least full year) contracts for their peak demand at the maximum

rate to assure that they will have the capacity they require during the peak season. Order No. 712-A P 44, JA 598.

The recourse rate for pipeline transactions thus ensures that pipelines have the proper incentive to build new capacity when capacity release prices show that construction of such capacity is needed and would be profitable. Order No. 712-A P 37, JA 597. “If prices in the short-term capacity release market generate revenues that would be above the cost of constructing new capacity, the pipeline can capture such potential profits only by adding capacity to serve the demand,” since the pipeline cannot raise its rates above the price cap. Order No. 637-A at 31,565. Accordingly, as long as cost-of-service rate ceilings apply, “pipelines [will] have a greater incentive to build new capacity to serve all the demand for their service, than to withhold capacity, since the only way the pipeline could increase current revenues and profits would be to invest in additional facilities to serve the increased demand.” Order No. 712 P 85, JA 498 (quoting *Regulation of Short-Term Natural Gas Transportation Services and Regulation of Interstate Natural Gas Transportation Services*, 101 FERC ¶ 61,127 at P 12 (2002), *on reh’g*, 106 FERC ¶ 61,088 (2004), *aff’d sub. nom.*, *American Gas Ass’n v. FERC*, 428 F.3d 255 (D.C. Cir. 2005)); Order No. 712-A P 19, JA 592 (citing Order No. 637 at 31,270). *See also Process Gas Consumers Group v. FERC*, 292 F.3d 831, 837 (D.C. Cir. 2002) (“because the Commission already regulates the rates pipelines

may charge and requires them to sell all available capacity at those rates, we agree with FERC that [the pipeline] has neither the legal ability to withhold existing capacity nor an incentive to refuse to build new capacity”).

Conversely, if the cost-based recourse rate requirement is removed, the incentive to construct when competitive conditions warrant may be undermined. Order No. 712-A P 36, JA 596. Pipelines have an incentive to withhold capacity, *i.e.* to *forego* construction, where they can garner extra-competitive returns in the short-term market. Order No. 712-A P 19, JA 592. Under basic economic theory, firms with market power, like pipelines, have an incentive to construct less capacity than competitive firms because additional construction lessens scarcity and the ability to charge extra-competitive rates. Order No. 712-A P 33, JA 595. Thus, “[i]f pipelines with market power find that maintaining scarce pipeline capacity increases their profits, then they will have much less incentive to construct long-term capacity because such capacity could result in lower profitability.” Order No. 712-A P 36, JA 596. The ability to recover extra-competitive rates blunts pipelines’ incentive to expand because any such expansion would reduce their scarcity revenues. *Id.* P 37, JA 597. Likewise, where an affiliate controls most of the capacity on a pipeline, the pipeline may have an incentive to withhold

capacity for the overall benefit of the corporate enterprise.⁵ Order No. 712-A P 35 n.50, JA 596.

As an example, after Order No. 712 became effective, capacity release prices exceeded maximum rates from the Rocky Mountains to the Northwest and to the East, due to scarce pipeline capacity. Order No. 712-A P 37, JA 597. Such scarcity should be a prime indicator to the pipelines of the need to expand capacity from the Rocky Mountains. *Id.* If pipelines were able to capture the higher than maximum rate prices for such transactions, however, their incentive to undertake such capacity expansion may be undermined. *Id.* The retention of the recourse rate for pipeline transactions ensures that pipelines have the proper incentive to build new capacity when capacity release prices show that construction of such capacity is needed and would be profitable. *Id.*

Due to circumstances like these, and because it did not do a market power study of the entire pipeline industry, Order No. 712-A P 26, JA 594, the Commission did not make a generic finding that the entirety of the secondary market was competitive, and continued to rely on the recourse rate as the backstop to protect shippers. Order No. 712 P 91, 102, JA 499, 501; Order No. 712-A PP

⁵ For example, as of 2000, 93 percent of the capacity of the Williston Pipeline was held by an affiliate, and affiliates on Equitrans, L.P, National Fuel Gas Supply Corp., and Questar Pipeline have a very high proportion of transportation service (from 50 percent-70 percent). Order No. 712-A P 25 & n.30, JA 593-94.

17, 20, 23, 25, 26, JA 592-94. Because pipelines can still exercise market power, the Commission could not find sufficient justification for removing recourse rate protection based solely on “the unsupported statements of pipelines that short-term rates will never be sufficient to reduce or eliminate the amount of long-term capacity they choose to construct.” Order No. 712-A P 36, JA 596.

2. Pipelines Can Restrain Capacity Competition From Shippers.

The Commission also found that, on many parts of the pipeline grid, sufficient competition may not exist to discipline pipeline pricing. Order No. 712 PP 61, 83, 88, JA 493, 497-98; Order No. 712-A P 25, JA 593. Although Pipelines claim the only evidence of this involved capacity controlled by shippers, Br. 28, 44, the Commission to the contrary specifically found circumstances under which pipelines may not face competition in the sale of their short-term capacity. Order No. 712 P 88, JA 498.

A variety of pipeline limitations on shippers’ release rights can limit the effectiveness of competition and arbitrage between the pipelines and releasing shippers. Order No. 712-A P 27, JA 594. For example, the Commission’s selective discounting policy permits pipelines to limit a shipper’s discount to specific points, so that those discounts cannot be arbitrated to alternate, less competitive points. Order No. 712-A P 27 n.32, JA 594. In order to release at an alternate point, the shipper must pay the pipeline’s maximum rate, thus reducing

that shipper's incentive to release capacity to a replacement shipper who will use less competitive points. Order No. 712 P 88, JA 498 (citing *Williston Basin Interstate Pipeline Co.*, 110 FERC ¶ 61,210 at P 22, *on reh'g*, 112 FERC ¶ 61, 038 (2005)); Order No. 712-A P 27 & n.32, JA 594.

In addition, a particular shipper's incentive to release capacity in competition with the pipeline could be reduced if its discounted or negotiated rate agreement contains a provision, as permitted by Commission policy, providing that the pipeline will share any revenues the shipper receives from a capacity release in excess of its discounted or negotiated rate. Order No. 712 P 88 n.95, JA 498; Order No. 712-A P 27, JA 594 (citing *LSP Cottage Grove, L.P. v. Northern Natural Gas Co.*, 111 FERC ¶ 61,108 PP 58-59 (2005)).

These provisions help to insulate pipelines from competition. Order No. 712-A P 27, JA 594 (citing *Williston Basin Interstate Pipeline Co. v. FERC*, 358 F.3d 45, 50 (D.C. Cir. 2004)). Pipelines should not, on the one hand, be able to employ these policies to insulate themselves from competition with releasing shippers, while, on the other hand, seeking to remove the recourse rate which serves to protect customers from the effects of such insulation. *Id.* Retaining the recourse rate helps protect against the exercise of market power on such segments. Order No. 712-A P 27, JA 594; Order No. 712 P 88, JA 498.

Not only may there be segments of a pipeline or even an entire pipeline that is not competitive, but perfect arbitrage does not exist between the capacity release market and the market for pipeline capacity. Order No. 712 P 107, JA 503; Order No. 712-A P 20, JA 592. As a result, pipelines may have the ability to exercise market power. *Id.* In balancing the risks and benefits of removing the price ceiling for pipeline capacity, the Commission chose to err on the side of providing greater protection against the exercise of market power by retaining the recourse rate protection of regulated pipeline rates. *Id.*

Pipelines assert that releasing shippers control more firm pipeline capacity than pipelines and are therefore more likely than pipelines to possess market power. Br. 32. As held in *INGAA*, however, this argument compares “apples and oranges.” Order No. 712 P 92, JA 499 (quoting *INGAA*, 285 F.3d at 35).

“[W]hereas the uncontracted capacity of a pipeline is presumptively available for the short-term market, no such presumption makes sense for the non-pipeline capacity holders: they presumably contracted for the capacity in anticipation of actually using it.” *Id.* (quoting *INGAA*, 285 F.3d at 35). Firm shippers must pay a reservation charge on capacity they reserve whether or not they use it. *See, e.g., Tennessee Gas Pipeline Co. v. FERC*, 400 F.3d 23, 25 (D.C. Cir. 2005); *North Baja Pipeline, LLC v. FERC*, 483 F.3d 819, 820 (D.C. Cir. 2007). Indeed, one of the goals of removing the rate ceiling on shipper releases was to afford firm

shippers a greater opportunity to defray the cost of their reservation charges. Order No. 637-A at 31,555. *See also* *INGAA*, 285 F.3d at 33. Thus, the fact that pipelines hold a small percentage of overall capacity does not allay concerns about the exercise of market power in peak periods, when firm shippers are most likely to be using their firm capacity.

Further, comparing the relative market shares of current capacity held by pipelines and releasing shippers does not reflect the more important relationship of the recourse rate ceiling to construction of new capacity infrastructure which is far more critical to ensuring that the pipeline grid is expanded to meet demand. Order No. 712 P 94, JA 500. Because the pipelines are the principal parties constructing additional capacity, it is crucial that their incentive to build is not diluted by the ability to earn scarcity rents in the short-term market. *Id.*

3. Recourse Rates Are Also Necessary To Restrain Shipper Market Power.

The Commission also reasonably retained the pipeline recourse rate because it protects not only against the exercise of pipeline market power, but also the exercise of market power by releasing shippers. Order No. 712 P 61, JA 493. *See* *INGAA*, 285 F.3d at 33 (affirming experimental removal of price ceiling for shipper releases because, *inter alia*, the maximum price ceiling for pipeline rates provides an important check on the ability of releasing shippers to exercise market power). Releasing shippers may control sufficient firm capacity to exercise market

power on some pipeline segments. This can occur on laterals, at the extreme ends of certain pipeline systems where only one or a small number of firm capacity holders are present, or in some cases on an entire small pipeline. Order No. 712-A P 25, JA 593. For example, Tuscarora Gas Transmission Company has a non-affiliated shipper with 77 percent of its capacity. Order No. 712-A P 25 n.30, JA 594. Indeed, “when the capacity available for sale on a particular pipeline is limited, holders of even relatively small capacity allotments can exercise market power.” Order No. 712-A P 17, JA 592 (quoting *United Distribution Cos.*, 88 F.3d at 1156).

On parts of the pipeline grid where all firm capacity may be held by only a few (or even one) firm shipper, the availability of the recourse rate prevents those shippers from withholding their capacity in order to charge a price above competitive levels. Order No. 712 P 61, JA 493; Order No. 712-A PP 17, 25, JA 592-93. If a releasing shipper seeks to charge more than the maximum rate for capacity, and the pipeline segment is not constrained, the replacement shipper would have the option of purchasing capacity from the pipeline at the cost-based just and reasonable interruptible or short-term firm rate. Order No. 712 P 61, JA 493; Order No. 712-A PP 17, 25, JA 592-93. Even if the pipeline capacity is constrained, “[i]n the short-term, a releasing shipper’s attempt to withhold capacity in order to raise prices above maximum rates will be undermined because the

pipeline will be required to sell that capacity as interruptible capacity to a shipper willing to pay the maximum rate.” Order No. 712-A P 24, JA 593 (quoting Order No. 637 at 31,282). *See also* *INGAA*, 285 F.3d at 33 (“[i]f holders of firm capacity do not use or sell all of their entitlement, the pipelines are required to sell the idle capacity as interruptible service to any taker at no more than the maximum rate -- which is still applicable to the pipelines”).

C. Based Upon The Foregoing, The Commission Reasonably Retained Pipeline Recourse Rates.

Based upon the foregoing, the Commission did not find the short-term capacity release market sufficiently competitive to remove the protection afforded by the recourse rate. Order No. 712-A P 25, JA 593. Precisely because the Commission did not make such a competitive market finding, the Commission “continu[es] to insist on the maintenance of the pipeline’s recourse rate as protection against the exercise of market power.” Order No. 712-A P 17, JA 592 (quoting Order No. 712 P 61, JA 493). Removing the rate ceiling for pipeline transactions would remove an important protection both for pipeline customers and for replacement shippers on capacity release transactions. Order No. 712 P 83, JA 497.

The Commission’s determination to permanently lift the price cap on shipper short-term capacity releases, while maintaining cost-of-service recourse rates for pipeline transactions, closely follows the analysis affirmed in *INGAA*.

The *INGAA* analysis was based on three factors: (1) the deference due agency experiments; (2) adequate ongoing regulation of the rates of interstate pipelines as natural monopolists; and (3) the need to assure that rates will remain just and reasonable if cost-based regulation is relaxed. *INGAA*, 285 F.3d at 30-31. Based on these factors, *INGAA* affirmed lifting the price cap on shipper releases, because the Commission made a substantial record for the proposition that shipper release transactions are sufficiently subject to competition -- and any exercise of market power by releasing shippers sufficiently restrained by the pipeline recourse rate and the requirement that pipelines sell all available capacity -- to expect that rates for shipper release transactions would fall within the zone of reasonableness. *INGAA*, 285 F.3d at 30-35. *INGAA* also upheld the Commission's decision not to lift the price ceiling for pipelines, as the Commission was free to undertake reform one step at a time, and would be overturned only if its gradualism "truly yields unreasonable discrimination or some other kind of arbitrariness." *Id.* at 35. The Court found the distinction between shipper capacity releases and pipeline capacity sales reasonable; "the distinction between pipelines and other holders of unused capacity, based on the probable likelihood of wielding market power, seems to us to pass muster." *Id.* at 36.

Pipelines assert that *INGAA* "has no applicability to the instant proceedings," because the results of the Order No. 637 experiment and other data now show that

the short-term markets are competitive, and pipelines lack market power, so there is no longer any reasonable basis for a distinction between pipelines and releasing shippers. Br. 52. However, as fully discussed in Argument Section II(B) *supra*, the Commission in Order No. 712 found, based upon a substantial record, that pipelines do still possess opportunities for the exercise of market power, and that retention of the pipeline recourse rate requirement remains necessary to protect against the exercise of market power. Order No. 712 P 88, JA 498; Order No. 712-A PP 17, 25, JA 592-93.

In other words -- because the Commission could not find that competition alone would adequately restrain market power -- the time has not yet come for the Commission to take the next step in undertaking reform. *See INGAA*, 285 F.3d at 35. As *INGAA* held, given the natural monopoly power over transportation, the Commission can only “dispens[e] with cost-based rate ceilings presumptively intended by Congress as a remedy,” and impose instead more relaxed (*i.e.* “light-handed”) regulation, if the Commission can show that the resulting rates may be expected to fall within a “zone of reasonableness.” *INGAA*, 285 F.3d at 31. *See* Order No. 712 P 38, JA 485. Here, the Commission could not “relax the recourse rate protection given that the entirety of the market has not been shown to be sufficiently competitive.” Order No. 712-A P 46, JA 599. *INGAA* thus fully supports the continuing distinction made here between releasing shippers and

pipelines “based on the probable likelihood of wielding market power.” *INGAA*, 285 F.3d at 36.

The differing treatment of releasing shippers and pipelines is not unduly discriminatory (Br. 19, 32-33, 40, 44), because “the essential differences between pipelines and releasing shippers justified their differential treatment.” Order No. 712 P 108, JA 503 (citing *INGAA*, 285 F.3d at 36). The NGA prohibits “unreasonable differences” in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service. *TransCanada Pipeline Ltd. v. FERC*, 878 F.2d 401, 413 (D.C. Cir. 1989) (citing NGA § 4(b)(2), 15 U.S.C. § 717c(b)(2)). “Mere difference, however, is not discriminatory; there must also be a demonstration that the two classes of customer are similarly situated for purposes of the rate.” *Tennessee Gas Pipeline Co. v. FERC*, 860 F.2d 446, 452 n.9 (D.C. Cir. 1988). “That the criteria governing permissible rates in . . . two categories are different . . . does not establish discrimination between them.” *Associated Gas Distributors v. FERC*, 824 F.2d 981, 1009 (D.C. Cir. 1987). Rather, “[d]ifferences . . . based on relevant, significant facts which are explained are not contrary to the NGA.” “*Complex*” *Consolidated Edison Co. v. FERC*, 165 F.3d 992, 1013 (D.C. Cir. 1999) (quoting *TransCanada*, 878 F.2d at 413). See also *Metropolitan Edison Co. v. FERC*, 595 F.2d 851, 857 (D.C. Cir. 1979) (“A

difference in rate treatment is not unduly discriminatory when the difference is amply justified”).

III. THE COMMISSION REASONABLY REJECTED PIPELINES’ CLAIMS OF INJURY.

A. The Commission Reasonably Rejected Arguments That Pipelines Are Denied Full Cost Recovery By Retention Of The Recourse Rate.

Pipelines assert that they will be unable to recover their cost-of-service if the recourse rate is retained, because “[p]ipelines must sell their unsubscribed capacity below the rate cap to meet competition during off-peak periods, but they are prevented from charging the market price during peak periods when the market price is greater than the rate cap.” Br. 37.

To the contrary, cost-of-service ratemaking provides each pipeline with an opportunity to recover all of its reasonably incurred costs. Order No. 712-A P 49, JA 599. Pipelines may still obtain full cost recovery even where they are required to discount their rates to meet competition. Order No. 712-A P 45, JA 599. Under longstanding Commission policy, pipelines may adjust the volumes used to design their maximum recourse rates, so that they can recover their full cost-of-service, even though competition requires them to offer discounts during off-peak periods. *Id.* (citing *Southern Natural Gas Co.*, 65 FERC ¶ 61,347 at 62,829-40 (1993), *on reh’g*, 67 FERC ¶ 61,155 at 61,456 (1994); *Williston Basin Interstate Pipeline Co.*,

67 FERC ¶ 61,137 at 61,377-83 (1994)). Also, pipelines have the option of applying for seasonal rates in such circumstances. Order No. 712-A P 45, JA 599.

Indeed, Pipelines would still be subject to cost-of-service regulation even if the recourse rate cap were removed from pipeline short-term services. Order No. 712-A P 49, JA 599. Under cost-of-service regulation, Pipelines would be required to account for any extra revenues derived from short-term services as part of their overall cost-of-service in the next NGA § 4 rate case. *Id.*

B. The Commission Reasonably Rejected Arguments That Pipelines Will Suffer Losses As A Result Of Their Allegedly Inferior Flexibility To Exceed The Maximum Rate.

Similarly, because pipelines can recover their full cost-of-service, the Commission reasonably rejected arguments that the pipelines will suffer losses as a result of the lack of flexibility of their pricing options as compared to those of releasing shippers. Order No. 712-A P 49, JA 599.

Under Commission policy, pipelines possess significant pricing discretion: (1) they can enter into negotiated rate transactions above the maximum rate, so long as the shipper has the option of purchasing at the cost-based recourse rate; (2) they can seek market-based rates by making a filing with the Commission establishing that they lack market power in the markets they serve; or (3) they can propose seasonal rates, which permit pipelines to recover more of their annual

revenue requirement in peak seasons. Order No. 712 PP 82, 86, JA 497-98; Order No. 712-A P 16, JA 591.

Pipelines complain that these alternatives are not as flexible as capacity release, and therefore that the Commission's policy unjustifiably injures pipelines. Br. 33-42. However, Pipelines -- even under their own proposed alternatives -- would continue to be regulated under cost-of-service principles; therefore, any lack of flexibility would not result in losses because cost-of-service ratemaking provides each pipeline with an opportunity to recover all of its reasonably incurred costs. Order No. 712-A P 49, JA 599. Indeed, "[i]f the Commission were to remove the recourse rate from the pipelines' short-term services, pipelines would still need to account for any extra revenues derived from short-term services as part of their overall cost-of-service." *Id.*

In fact, the purpose of lifting the price cap on capacity releases in Order No. 712 was to give releasing shippers some of the same pricing flexibility already enjoyed by the pipelines. Order No. 712 P 86, JA 498. Prior to Order No. 712, pipelines were using their negotiated rate authority to sell their own capacity at prices based on basis differentials derived from gas commodity price indices,⁶

⁶ Gas commodity price indices reflect gas prices at particular points such as gas production basins or certain receipt and delivery points and citygates. The "basis differential" transportation pricing mechanism is based upon the difference between the gas price indices at the two points of receipt and delivery. The

which could at times exceed the recourse rate. Proposed Rule P 24. Releasing shippers -- unlike pipelines -- had no ability to enter into negotiated rate transactions above the pipeline's recourse rate. Order No. 712 P 86, JA 498. Accordingly, releasing shippers were unable effectively to use basis differentials as a pricing mechanism because they could not recover the value of capacity when the value exceeded the maximum rate cap. *Id.* P 35, JA 484. One of the primary reasons for removing the rate ceiling on shipper capacity releases was to permit shippers to exceed the maximum rate when they were releasing capacity at index prices. Order No. 712 PP 83, 86, JA 497-98; Order No. 712-A PP 16, 43, JA 591, 598.

Pipelines nevertheless assert that their negotiated rate authority is inferior to shipper flexibility because pipelines must offer a cost-based recourse rate alternative, and shippers will not enter into contracts above the recourse rate. Br. 37-38. However, the principal use of pipeline negotiated rates is to enable pipelines to price transactions using basis differentials. Order No. 712-A P 43, JA 598; Proposed Rule P 24. Pipelines offer no reason why shippers would be any more reluctant to contract with pipelines using basis differential pricing than they

difference in price between two points, as shown by the respective price indices, reflects the value of transportation between the two points. *See n.3 supra.*

would be to contract with releasing shippers using basis differential pricing. Order No. 712-A P 43, JA 598.

Further, while the Commission has never granted market-based rate authority to a major pipeline (Br. 39), this does not undermine the validity of market-based rates as an option, but rather strongly evidences continuing pipeline market power. Order No. 712 P 99, JA 501. The Commission has considered pipeline claims that competition is sufficient to permit market-based rates for transportation services, but the pipelines so far have been unable to make such a showing. Order No. 712 PP 90 & n.96; 99 & n.101, JA 499, 501 (citing cases). This fact explains the Commission's reluctance to remove the recourse rate requirement. Order No. 712 P 99, JA 501. It is precisely because pipelines have such enormous economies of scale and enjoy market power, that the application of economically correct standards, *i.e.*, the "individualized litigation" of which Pipelines complain, *see* Br. 40, is appropriate in reviewing an application to remove rate regulation entirely. Order No. 712-A P 48, JA 599.

While Pipelines assert that individualized review of pipeline market power is discriminatory when compared to releasing shippers' blanket authority, Br. 40, the blanket authority for releasing shippers is permissible precisely because the pipeline recourse rate checks any ability of releasing shippers to exercise market power. Order No. 712 P 101, JA 501. The analysis the Commission employed in

providing blanket authority to releasing shippers therefore is more comparable to that used for pipeline negotiated rates than for pipeline market-based rates. Order No. 712 P 102, JA 501. As with pipeline negotiated rates, the availability of the recourse rate provides sufficient protection from the exercise of market power to enable the Commission to remove the price ceiling for short term capacity releases without a more detailed market power analysis, such as the one employed in determining whether a pipeline can use market-based rates. *Id.* In contrast, there are sufficient concerns about the ability of pipelines to exercise market power in short-term transactions, on at least some segments of their systems, that a blanket removal of the price cap on all such pipeline transactions in this rulemaking proceeding, without consideration of specific circumstances on individual pipeline systems, would be inappropriate. *Id.*

Pipelines also complain that seasonal rates, which must be set in an individual rate proceeding, do not provide the pricing flexibility of capacity release. Br. 41-42. The Commission, however, did not maintain that these programs were identical, but simply pointed to seasonal rates as potential flexibility that is available to the pipelines. Order No. 712-A P 49, JA 599. The use of seasonal rates may be a solution for situations in which demand differs significantly between seasons, requiring discounting during off-peak periods. *Id.* Although Pipelines complain that seasonal rates continue to be capped at the cost

of service, Br. 42, this will not result in losses to the pipeline because cost-of-service ratemaking provides each pipeline with an opportunity to recover all reasonably incurred costs. Order No. 712-A P 49, JA 599.

Generally, Pipelines assert that retaining pipeline price caps is overinclusive because it regulates pipelines in competitive markets, and underinclusive, because the Commission should regulate releasing shipper market power. Br. 43-44. The fact remains, however, that the Commission was unable to determine that competition in the short-term capacity market would sufficiently restrain pipeline market power without complementary regulatory restraints. Accordingly, maintenance of those complementary regulatory restraints, at least for now under the record compiled in this generic proceeding, was required under the NGA. Those same regulatory restraints also provide a sufficient check on the potential exercise of market power by releasing shippers, which obviates the need for any further regulatory check specific to such shippers. Under such circumstances, the Commission reasonably concluded that removing the price ceiling from releasing shipper transactions, while maintaining the recourse rate requirement for pipeline short-term transactions, best maximized both the freedom of the market to reflect the real value of transaction while at the same time maintaining necessary protections against the exercise of market power. Order No. 712 PP 30-31, JA 483; Order No. 712-A P 16, JA 591. While the flexibility offered to pipelines and

shippers is not identical, the differences are attributable to the need to maintain the pipeline recourse rate to provide an effective check on both pipeline and releasing shipper market power. Order No. 712 P 98, JA 501. The Commission sought to provide both pipelines and shippers “with reasonably comparable flexibility consistent with the differences between these entities and the need to provide protection against market power.” *Id.*

IV. THE COMMISSION REASONABLY REJECTED PIPELINES’ PROPOSED ALTERNATIVES.

Pipelines assert that the Commission erred in failing to adopt the alternatives proposed by Spectra: (1) adopting an auction mechanism for pipeline short-term capacity sales on either a permanent or experimental basis; or (2) retaining the recourse rate only for interruptible service. *See* Br. 44-50.

In the first instance, Pipelines suffer no losses from the failure to adopt these alternatives because, even under Spectra’s proposals, pipelines would continue to be subject to cost-of-service regulation, and therefore would be required to account for any extra revenues derived from short-term services as part of their overall cost of service. Order No. 712-A P 49, JA 599. Further, the auction proposal is jurisdictionally barred, and the Commission reasonably rejected all alternatives because Spectra failed to show that they would adequately constrain pipeline market power. Order No. 712-A PP 55-56, JA 600.

The Court is jurisdictionally barred from considering Spectra's auction proposal (whether permanent or experimental), because -- as Spectra concedes, Br. 45-46 -- Spectra first presented the auction proposal in its request for rehearing of Order No. 712, and Spectra failed to seek rehearing of the Commission's decision in Order No. 712-A to reject the auction proposal for the first time. Under NGA § 19(b), 15 U.S.C. § 717r(b), "[n]o objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for the failure to do so." Because Spectra first raised its auction proposal in its rehearing request, *see* Order No. 712-A P 56, JA 600, and the Commission rejected that proposal for the first time in Order No. 712-A, it was incumbent upon Spectra to seek rehearing of Order No. 712-A (the aggrieving order on this issue) to preserve the auction proposal for appellate review. *Town of Norwood v. FERC*, 906 F.2d 772, 775 (D.C. Cir. 1990) (Court lacked jurisdiction to hear a challenge to a Commission finding made for the first time on rehearing in Opinion No. 310-A where petitioner failed to seek rehearing of Opinion No. 310-A); *Tennessee Gas Pipeline Co. v. FERC*, 871 F.2d 1099, 1110 (D.C. Cir. 1989) (Court lacked jurisdiction to hear a challenge to an effective date set for the first time in a rehearing order where the petitioner failed to seek rehearing of the rehearing order).

In any event, the Commission reasonably rejected Spectra’s auction proposal. Order No. 712-A PP 55-56, JA 600. Spectra proposed that pipelines could “opt” to post “some” of their capacity, using “the same mechanism and safeguards as short-term capacity release, including the ability of the pipeline to designate a minimum rate that is at or below the recourse rate, below which a bid will not qualify.” Spectra Request for Rehearing, R. 101 at 36, JA 581. This proposal failed to meet the requirements and guidance for pipeline auction proposals in Order No. 637, in particular the requirement that any proposal protect against the exercise of market power by the pipeline. Order No. 712-A PP 55-56, JA 600. Spectra provided no details about how it would structure its proposed auctions to ensure that pipelines cannot exercise market power, to ensure that sufficient arbitrage opportunities exist so that releasing shippers can compete equally, and to ensure that the pipeline retains an incentive to construct long-term capacity when it is needed. *Id.* P 56, JA 600.

More specifically, Order No. 637 required that, “[i]n a proposal for auctions without a rate cap, all capacity available at the time of the auction would have to be included in the auction.” *Id.* P 55, JA 600 (quoting Order No. 637 at 31,295). Spectra’s proposal that pipelines could “opt” to post “some” capacity failed to meet this requirement. Spectra Request for Rehearing, R. 101 at 36, JA 581.

Order No. 637 also required that any auction proposal “address the appropriate limitations that should be placed on the level at which the pipeline can establish reserve prices, particularly whether different reserve prices should be established for peak and off-peak capacity.” Order No. 712-A P 55, JA 600 (quoting Order No. 637 at 31,295). The concern with reserve prices was to ensure that, if a pipeline can benefit from competition by selling at above the maximum rate during peak periods, it also should be required to sell capacity at more competitive prices during off-peak periods. *Id.* P 55 n.61, JA 600. If pipelines were permitted to set the reserve price at the existing maximum rate during off-peak periods, they still would be able to exercise market power with respect to off-peak transactions, for example, by selectively discounting. *Id.* Requiring the pipeline to set a lower reserve price during off-peak periods would ensure more competitive pricing during all time periods. *Id.* Spectra’s proposal that pipelines be able “to designate a minimum rate that is at or below the recourse rate,” Spectra Request for Rehearing, R. 101 at 36, JA 581, failed to meet this requirement.

Further, because Spectra raised its auction proposal for the first time on rehearing, other parties had no opportunity to comment on the details of such a proposal, and the Commission, therefore, did not have a sufficient record to rule on a generic basis on such a proposal in this rulemaking. Order No. 712-A P 56, JA 600. Spectra, and other pipelines, can still make such a proposal through an NGA

§ 4 filing on an individual case-by-case basis, consistent with the directives set forth in Order No. 637. *Id.*

The Commission also reasonably rejected Spectra's proposal to retain the price cap only on short-term interruptible services. Spectra Request for Rehearing, R. 101 at 36, JA 581. This proposal also failed to specify the details of how the proposed plan would work and how it would protect against pipeline market power. Order No. 712-A P 56 n.63, JA 601. For example, the Commission expressed concern that lifting the price ceiling on pipeline short-term firm capacity would create an incentive for pipelines to forgo the sale of firm capacity for periods of more than a year in order to reap the uncapped rates that would be available in the short term. Order No. 712 P 107 n.108, JA 503. Spectra did not explain how short-term firm capacity would be differentiated from long-term firm capacity, since the same capacity can be purchased for short or long-term use. Order No. 712-A P 56 n.63, JA 601. Spectra also failed to explain how bidding on short-term and long-term capacity would be evaluated to ensure that the pipeline was not favoring a short-term bid over a long-term bid. *Id.*

While Pipelines consider these concerns "details" that can be addressed in individual pipeline compliance proceedings, Br. 48, the Commission's concern was not with "details" but rather with Spectra's failure to demonstrate that its proposals would adequately constrain pipeline market power. Order No. 712-A PP

55-56 & n.63, JA 600-01. Absent such a demonstration, the Commission could not, consistent with its NGA responsibilities, and especially in a generic across-the-board rulemaking proceeding, approve lifting the price cap on pipeline short-term capacity sales. Given pipelines' natural monopoly power over transportation, the Commission can only "dispens[e] with cost-based rate ceilings presumptively intended by Congress as a remedy," and impose instead more relaxed (*i.e.* "light-handed") regulation, if the Commission can show that the resulting rates may be expected to fall within a "zone of reasonableness." *INGAA*, 285 F.3d at 31; Order No. 712 P 38, JA 485.

Accordingly, while the Commission has "a duty to consider responsible alternatives to its chosen policy," Br. 48-49 (quoting *Farmers Union*, 734 F.2d at 1511), that duty extends only to "significant and viable" alternatives. *Farmers Union*, 734 F.2d at 1511 n.54. Here, as the Commission explained, Spectra's proposed alternatives were not viable because Spectra failed to show how they met the fundamental requirement of constraining pipeline market power. "In offering an explanation for rejecting the alternative, the Commission was not required to do more." *American Radio Relay League, Inc. v. FCC*, 524 F.3d 227, 242 (D.C. Cir. 2008) (cited Br. 49).

Pipelines also find the Order No. 712 Rule "flawed" because it will result in a bifurcated market for short-term capacity. Br. 50. However, the Commission

has undertaken a number of steps to reduce the cost and improve the efficiency of arbitrage over the years, which should reduce the incidence of any bifurcation. Order No. 712 P 106, JA 503; Order No. 712-A P 51, JA 599. While a bifurcated market may at times occur, Order No. 712 P 107, JA 503; Order No. 712-A P 52, JA 600, this does not support removing the recourse rate requirement because impediments to arbitrage may *enhance* pipeline market power. Order No. 712 P 107, JA 503; Order No. 712-A P 52, JA 600. For example, in order to preserve the benefits of selective discounting, the Commission permits pipelines to include provisions in discounted rate agreements which may reduce a shipper's incentive to engage in arbitrage under certain circumstances. Order No. 712 P 107, JA 503.

Accordingly, any limited market bifurcation that remains is a cost that must be incurred to maintain the protection against market power afforded by the recourse rate. Order No. 712 P 108, JA 503; Order No. 712-A P 53, JA 600. In contrast -- contrary to Pipelines' assertions, *see* Br. 50 -- Spectra failed to show that any of its proposed alternatives would protect against market power. Order No. 712-A PP 55-56 & n.63, JA 600-01. *INGAA* recognized the importance of the same trade-off between the possible bifurcation of the market and the need to continue to regulate pipeline short-term capacity. *See INGAA*, 285 F.3d at 36. The Court concluded, as did the Commission here, that the essential differences in the potential market power of pipelines and releasing shippers justified their different

treatment: “Here, the distinction between pipelines and other holders of unused capacity, based on probable likelihood of wielding market power, seems to us to pass muster.” Order No. 712 P 108, JA 504 (quoting *INGAA*, 285 F.3d at 36).

CONCLUSION

For the foregoing reasons, FERC respectfully requests that the petition for review be denied and FERC's orders upheld in all respects.

Respectfully submitted,

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No. 09-1016

CERTIFICATE OF COMPLIANCE

In accordance with Fed. R. App. P. 32(a)(7)(C), I hereby certify that this brief contains 13,101 words, not including the tables of contents and authorities, the glossary, the certificate of counsel and this certificate.

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STATUTORY

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Natural Gas Act:

Section 4, 15 U.S.C. § 717c.....1-3

Section 19(b), 15 U.S.C. § 717r(b).....4

Section 4 of the Natural Gas Act, 15 U.S.C. § 717c, provides as follows:

§ 717c. Rates and charges

(a) Just and reasonable rates and charges

All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is declared to be unlawful.

(b) Undue preferences and unreasonable rates and charges prohibited

No natural-gas company shall, with respect to any transportation or sale of natural gas subject to the jurisdiction of the Commission,

(1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or

(2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

(c) Filing of rates and charges with Commission; public inspection of schedules

Under such rules and regulations as the Commission may prescribe, every natural-gas company shall file with the Commission, within such time (not less than sixty days from June 21, 1938) and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection, schedules showing all rates and charges for any transportation or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

(d) Changes in rates and charges; notice to Commission

Unless the Commission otherwise orders, no change shall be made by any natural-gas company in any such rate, charge, classification, or service, or in any rule, regulation, or contract relating thereto, except after thirty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the thirty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(e) Authority of Commission to hold hearings concerning new schedule of rates

Whenever any such new schedule is filed the Commission shall have authority, either upon complaint of any State, municipality, State commission, or gas distributing company, or upon its own initiative without complaint, at once, and if it so orders, without answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of the suspension period, on motion of the natural-gas company making the filing, the proposed change of rate, charge, classification, or service shall go into effect. Where increased rates or charges are thus made effective, the Commission may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any amounts ordered by the Commission, to keep accurate

accounts in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts were paid, and, upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the portion of such increased rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

Section 19(b) of the Natural Gas Act, 15 U.S.C. § 717r(b), provides as follows:

(b) Review of Commission order

Any party to a proceeding under this chapter aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the court of appeals of the United States for any circuit wherein the natural-gas company to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be transmitted by the clerk of the court to any member of the Commission and thereupon the Commission shall file with the court the record upon which the order complained of was entered, as provided in section 2112 of title 28. Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record with it shall be exclusive, to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which is supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in section 1254 of title 28.

CERTIFICATE OF SERVICE

In accordance with Fed. R. App. P. 25(d), and the Court's Administrative Order Regarding Electronic Case Filing, I hereby certify that I have, this 20th day of January 2010, served the foregoing upon the counsel listed in the Service Preference Report via email through the Court's CM/ECF system or via U.S. Mail, as indicated below:

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