

Fremont NDB (lat. 41° 27' 02" N., long. 96° 31' 13" W.)

That airspace extending upward from 700 feet above the surface within a 7-mile radius of the Fremont Municipal Airport, excluding that airspace within the Scribner, NE, Class E and the Wahoo, NE, Class E airspace areas.

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Issued in Kansas City, MO, on May 20, 2002.

**Herman J. Lyons, Jr.,**

Manager, Air Traffic Division, Central Region.

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## DEPARTMENT OF ENERGY

### Federal Energy Regulatory Commission

#### 18 CFR Part 284

[Docket No. RM98-10-010]

#### Regulation of Short-Term Natural Gas Transportation Services, and Regulation of Interstate Natural Gas Transportation Services

Issued May 16, 2002.

**AGENCY:** Federal Energy Regulatory Commission, DOE.

**ACTION:** Interim policy on certain remanded issues.

**SUMMARY:** On April 5, 2002, the United States Court of Appeals for the District of Columbia Circuit issued an opinion, generally affirming Order No. 637 concerning short-term and interstate natural gas transportation service. However, among other things, the Court vacated and remanded the policy that existing customers need only match a contract term of up to five years when exercising their right of first refusal. To prevent confusion in contracting and disruption to the market during the brief, but unavoidable, interim before the Commission can fully address the issues raised in the Court's remand, the Commission is issuing this Interim Policy, providing for the term cap currently in the pipelines' tariffs to govern the right of first refusal during the interim period.

The Court also remanded the policy adopted in Order No. 637 that pipelines must permit segmented forwardhaul and backhaul transactions to the same delivery point, each of which may use mainline capacity up to the contract demand of the underlying contract. The Commission will not address that issue in the individual pipeline proceedings to comply with Order No. 637 until after the issuance of the order on remand.

**EFFECTIVE DATE:** The interim policy is effective May 16, 2002.

**FOR FURTHER INFORMATION CONTACT:** Richard Howe, Office of the General Counsel, Federal Energy Regulatory Commission, 888 First Street, NE., Washington, DC 20426, (202) 208-1274.

#### SUPPLEMENTARY INFORMATION:

#### Federal Energy Regulatory Commission

Before Commissioners: Pat Wood, III, Chairman; William L. Massey, Linda Breathitt, and Nora Mead Brownell; Regulation of Short-Term Natural Gas Transportation Services, and Regulation of Interstate Natural Gas Transportation Services

[Docket No. RM98-10-010]

#### Interim Policy on Certain Remanded Issues

Issued May 16, 2002.

On April 5, 2002, the United States Court of Appeals for the District of Columbia Circuit issued an opinion,<sup>1</sup> generally affirming Order No. 637.<sup>2</sup> However, among other things, the Court vacated and remanded the policy adopted in Order Nos. 636 and 637 that existing customers need only match a contract term of up to five years when exercising their right of first refusal. To prevent confusion in contracting and disruption to the market during the brief, but unavoidable, interim before the Commission can fully address the issues raised in the Court's remand, the Commission is issuing this Interim Policy, providing for the term cap currently in the pipelines' tariffs to govern the right of first refusal during the interim period.

The Court also remanded the policy adopted in Order No. 637 that pipelines must permit segmented forwardhaul and backhaul transactions to the same delivery point, each of which may use mainline capacity up to the contract demand of the underlying contract. The Commission will not address that issue in the individual pipeline proceedings to comply with Order No. 637 until after the issuance of the order on remand.

This order is in the public interest because it clarifies for pipelines and their customers the policies to be in effect while the Commission considers the Court's remand.

<sup>1</sup> Interstate Natural Gas Association of America v. FERC, 2000 U.S. App. LEXIS 6219 at \*70-\*78 (No. 98-1333) (D.C. Cir. April 5, 2002) (*INGAA*).

<sup>2</sup> Regulation of Short-Term Natural Gas Transportation Services and Regulation of Interstate Natural Gas Transportation Services, FERC Stats. & Regs. Regulations Preambles (July 1996-December 2000) ¶ 31,091 (February 9, 2000); *order on rehearing*, Order No. 637-A, FERC Stats. & Regs. Regulations Preambles (July 1996-December 2000) ¶ 31,099 (May 19, 2000); *order denying reh'g*, Order No. 637-B, 92 FERC ¶ 61,062 (2000).

#### Background

In Order No. 436, the Commission adopted a regulation giving pipelines pre-granted abandonment authority under Section 7(b) of the NGA, 15 U.S.C. 717f(b), to terminate open access transportation service to a shipper once its contract had expired and it had no contractual right of renewal.<sup>3</sup> In Order Nos. 500-H and 500-I, the Commission interpreted that regulation as applying to all open access transportation services, including transportation service provided to the pipelines' historic sales customers who converted their sales service to transportation service. On review of Order Nos. 500-H and 500-I, the court remanded the issue of pre-granted abandonment authority to the Commission, finding that the Commission had not "adequately explained how pregranted abandonment trumps another basic precept of natural gas regulation—protection of gas customers from pipeline exercise of monopoly power through refusal of service at the end of a contract period."<sup>4</sup>

In the subsequent Order No. 636 proceeding, the Commission determined that pre-granted abandonment authority would be tempered with a right of first refusal for firm customers with a contract longer than one year.<sup>5</sup> Accordingly, Order No. 636 adopted a regulation providing that such a shipper could retain its service under a new contract by matching the term and the rate (up to the maximum rate) offered by the highest competing bidder.<sup>6</sup> In Order No. 636, the Commission contemplated that the bids the existing shipper must match could be for any contract length. However, on rehearing, in Order No. 636-A, the Commission capped the contract length the existing shipper must match at 20 years. The Commission did not, however, amend

<sup>3</sup> 18 CFR 284.221(d) (2001).

<sup>4</sup> American Gas Association v. FERC, 912 F.2d 1496, 1518 (D.C. Cir. 1990). (*AGA*).

<sup>5</sup> Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation; and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, Order No. 636, 57 FR 13267 (April 16, 1992), FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996 ¶ 30,939 at 30,446-48 (April 8, 1992); *order on reh'g*, Order No. 636-A, 57 FR 36,128 (August 12, 1992), FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996 ¶ 30,950 (August 3, 1992); *order on reh'g*, Order No. 636-B, 57 Fed. Reg. 57,911 (December 8, 1992), 61 FERC ¶ 61,272 (1992); *reh'g denied*, 62 FERC ¶ 61,007 (1993); *aff'd in part and remanded in part*, United Distribution Companies v. FERC, 88 F.3d 1105 (D.C. Cir. 1996); *order on remand*, Order No. 636-C, 78 FERC ¶ 61,186 (1997).

<sup>6</sup> 18 CFR 284.221(d)(2)(ii) (2001).

the regulation adopted in Order No. 636 to include the 20-year cap.

On appeal, however, the Court found the 20-year cap was not justified by the record and remanded it for further explanation.<sup>7</sup> The Court stated that the Commission had not adequately explained how the twenty-year term matching cap protects against the pipelines' preexisting market power, particularly why the 20-year cap would prevent bidders on capacity constrained pipelines from using long contract duration as a price surrogate to bid beyond the maximum approved rate, to the detriment of captive customers. On remand, the Commission changed its policy and adopted a five-year term matching cap in Order No. 636-C. It relied on the fact most commenters in the Order No. 636 proceeding had supported a term matching cap in the range of five years and more recent evidence showed that five years was about the median length of all contracts of one year or longer between January 1, 1995 and October 1, 1996.<sup>8</sup> Since the 20-year term matching cap had not been included in the Commission's regulations, this change did not require any change in the Commission's regulations. However, the Commission required all pipelines whose current tariffs contained term caps longer than five years to revise their tariffs consistent with the new policy.

On rehearing, in Order No. 636-D, the Commission recognized that pipelines had raised legitimate concerns about whether the five year term matching cap was causing a bias toward short-term contracts, with adverse economic consequences for both pipelines and captive customers. However, the Commission deferred further consideration of the term cap to the proceeding which became the Order No. 637 proceeding in Docket No. RM98-10-000, where a more current record could be developed.

In the Order No. 637 proceeding, the Commission continued the five-year cap policy, finding that none of the parties presented evidence to support the conclusion that a five-year contract is atypical in the current market. On appeal, the Court found that, in doing so, the Commission did not address any of the objections that had been raised concerning the five-year cap and had relied on the same evidence that it had used to make its decision in Order No. 636-C, namely the fact that five years was about the median length of all

contracts of one year or longer.<sup>9</sup> The Court concluded that the only evidence supporting the Commission's final decision to choose a five-year cap was the original record, which in the Commission's own view was incomplete. The Court held the Commission had neither given an affirmative explanation for its selection of five years, nor had it responded to its own or the pipelines' objections to the five-year cap. The Court also questioned why the Commission used a median to function as a ceiling. Consequently, the Court vacated the five-year cap and remanded the issue to the Commission.<sup>10</sup>

In the Order No. 637 proceeding, the Commission also addressed segmentation of capacity, under which shippers may divide their mainline capacity into segments with each mainline segment equal to the contract demand of the original contract. As a general matter, shippers may overlap those mainline segments, but only up to the contract demand of the underlying contract. In Order No. 637-A, the Commission clarified that a shipper using a forwardhaul and backhaul to bring gas to the same delivery point in an amount that exceeds its contract demand is not overlapping mainline capacity. On appeal the Court found that the Commission had not adequately addressed whether this policy modified the contracts between the pipeline and its shippers or adequately supported the need for any contract modification.

#### Discussion

The Commission lacks a sufficient record at this time to respond to the Court's concerns regarding the term cap used for the right of first refusal. As the Court itself noted, the most recent evidence developed in the prior proceedings concerned contract term lengths during the years 1995 to 1996. In addition, the Commission must address the objections that have been raised by the pipelines and other parties and those which it has raised itself. The Commission intends to proceed expeditiously to solicit evidence and views concerning the length of the term cap.

However, there will inevitably be a gap between the time the Court's mandate issues, and the time the Commission can issue a substantive order on remand responding to the Court's concerns about the term matching cap. This raises the question

of how the right of first refusal is to be exercised in the meantime as long-term contracts with right of first refusal rights expire. The Commission is concerned that uncertainty over the exercise of those rights could cause market disruption and believes that existing shippers and competitors for their capacity need to be able to negotiate new contracts without the uncertainty that a contract could be invalidated by the Commission's determinations concerning the term cap in an order on remand.

In the interim, the Commission continues the term cap of five-years currently in pipeline tariffs as an interim policy. The Commission will not apply its subsequent order on the merits of the Court's remand on this issue to overturn any contracts entered into under this interim policy. This will enable existing shippers with a right of first of refusal, and competitors for their capacity, to compete for that capacity under known rules that will not change, and thus avoid upsetting their expectations.

This Interim Policy will govern the term cap for contracts with the right of first refusal and will be effective from the date of issuance of this policy statement until the Commission adopts a different policy or rule on the maximum term that a holder of a contract with a right of first refusal must meet to retain its contract.

The Commission also intends to solicit comments on the remanded forwardhaul/backhaul issue. The Commission required pipelines to allow a shipper to deliver full contract quantities via forwardhauls and backhauls to a single delivery point as part of its general requirement that shippers be permitted to segment their capacity. Whether individual pipeline tariffs improperly restrict segmentation is currently being addressed pursuant to NGA section 5 in the pipeline filings to comply with Order No. 637. Until the Commission has acted on the Court's remand of the backhaul/forwardhaul issue, the Commission will not be in a position to make the necessary section 5 findings in the compliance proceedings to require pipelines to permit backhauls and forwardhauls to the same point. Therefore, the Commission will not address that issue in the compliance proceedings until after the issuance of the order on remand.

By the Commission.

**Magalie R. Salas,**  
Secretary.

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<sup>7</sup> United Distribution Companies v. FERC, 88 F.3d 1105, 1140-41 (D.C. Cir. 1996) (UDC).

<sup>8</sup> Order No. 636-C at 61,774 and 61,792.

<sup>9</sup> INGA at \*78.

<sup>10</sup> The Court also remanded to the Commission the question of whether the Commission's ROFR regulation or the provisions in a pipeline's tariff govern the conduct of the ROFR process.