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UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Promotion of a More Efficient Capacity Release Market) **Docket No. RM08-1-000**)

COMMENTS OF THE INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA

Pursuant to the Commission's Notice of Proposed Rulemaking ("NOPR") issued November 15, 2007, 121 FERC ¶ 61,170, the Interstate Natural Gas Association of America (INGAA) submits the following comments on the Commission's proposed revisions to its regulations governing short-term natural gas transportation service and the release of pipeline capacity held by shippers of natural gas. INGAA represents the interstate and interprovincial natural gas pipeline industry operating in North America. INGAA's United States members, which account for over 95 percent of all natural gas transported and sold in domestic interstate commerce, are regulated by the Commission pursuant to the Natural Gas Act (NGA), 15 U.S.C. §§ 717-717w. Because INGAA's members play an important role in administering the Commission's capacity release program under Order Nos. 636[1] and 637,[2] and in many cases offer their own capacity in competition with capacity being released by shippers, INGAA has as an interest in these proceedings.

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

[2] *Regulation of Short-Term Natural Gas Transportation Services and Regulation of Interstate Natural Gas Transportation Services*, FERC Stats. & Regs., Preambles (1996 – 2000) ¶ 31,091; *on reh'g*, Order No. 637-A, *id.* at ¶ 31,099; *on reh'g*, Order No. 637-B, 92 FERC ¶ 61,062 (2000), a*ff'd in part, remanded in part, INGAA v. FERC,* 285 F.3d 18 (D.C. Cir. 2002).

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I. SUMMARY OF INGAA COMMENTS

In general, INGAA supports the more light-handed approach to regulation of the secondary market for released capacity proposed in the NOPR.

A. With respect to lifting the pricing ceiling in the short-term market for capacity, the Commission's proposal does not go far enough. INGAA agrees with the Commission's conclusion as to the competitiveness of the short-term market following pipeline unbundling and the attendant open access regulations that have accorded shippers substantial additional rights in accessing and using the capacity that they purchase from pipelines (e.g., capacity release, flexible point and segmentation rights). The same evidentiary record relied upon by the Commission to propose lifting the ceiling on capacity releases, however, also shows that the entire market -- including short-term pipeline services -- is competitive. Accordingly, the Commission should expand its proposal to lift the rate ceilings on the entire short-term market. It is arbitrary to propose an asymmetric standard that deregulates one group of competitors operating in the same market while subjecting others -- pipelines -- to price caps unless they can demonstrate that they lack market power in a market the Commission has already found competitive. In any event, the Commission's reasoning for excluding the pipelines' short-term capacity in its proposal is flawed.

B. The suggestion that pipelines already have equivalent pricing flexibility available to them under the Commission's market based, negotiated, and seasonal rate policies is not realistic. None of these existing policies offer practical mechanisms for pipelines to compete on an even paying field with the Commission's proposal to uncap short-term capacity releases.

1. Market based pricing for pipelines is subject to a market power test that has only twice passed muster with the Commission. Moreover, the market power test involves lengthy and costly administrative proceedings that make it impractical for pipelines to even seek the authority to engage in market responsive, head to head competition with capacity releases.

2. Similarly, pipelines' ability to negotiate rates above the maximum rate does not put pipeline capacity on the same footing as capacity releases. While pipelines currently may negotiate rates above their maximum recourse rate, the negotiation is always subject to the shipper's right to elect the recourse rate, and implementation is subject to regulatory delays. Moreover, a shipper offering a negotiated rate over the recourse rate is treated as having offered only the recourse rate for purposes of evaluating bids and allocating capacity. Thus, the negotiated rate program offers pipelines very little, if any, opportunity to employ market based pricing to allocate capacity efficiently to those who desire it most. The Commission's proposal to permit market pricing of capacity releases in the short-term market will facilitate more efficient allocation of capacity by permitting shippers to lock-in short-term firm service (without the risk of the capacity being reduced pro rata with lower paying recourse rate shippers) by paying market rates for released capacity. Only releasing shippers (and replacement shippers seeking arbitrage opportunities), however, will be able to sell such market-based capacity with unfettered firm rights. It is only the actual investors in the physical pipeline facility that will be precluded from selling their short-term capacity at a market rate.

3. Nor does the availability of seasonal rate flexibility satisfactorily address pipelines' competitive disadvantage under the Commission's proposal: seasonal rates result

in new recourse rates, capped at the pipeline's annual revenues, not the ability to charge rates in excess of recourse rates.

In sum, under the Commission's proposal, the playing field would not be level for pipelines and their capacity-releasing shippers.

C. The Commission's' concern with pipeline market power is not applicable in the short-term capacity market.

1. The suggestion that pipeline pricing in that market needs to be restricted because pipeline ownership of capacity is more concentrated than that of shipper capacity holdings is based on a pre-restructuring, pre-open access view of the industry, and is inconsistent with the contemporary empirical evidence the Commission has collected concerning market power in the short-term capacity market. Moreover, it does not take into consideration that the *control* of the short-term market is now primarily in the hands of pipelines' firm shippers following pipeline unbundling and the attendant open access regulations that have accorded shippers substantial additional rights in accessing and using the capacity that they purchase from pipelines (e.g., capacity release, flexible point and segmentation rights). Those enhanced shipper rights have produced a competitive short-term market that cannot reasonably be bifurcated based on the identity of the seller. All sellers into that competitive short-term market should have the same pricing freedom if the Commission's allocative efficiency goals are to be met.

2. The notion that continued rate regulation of short-term pipeline rates is required to provide an incentive for pipelines to invest in the construction of needed pipeline infrastructure is unsupported. If the existing negotiated rate program allows pipelines to charge above the recourse rate, then this concern regarding incentives to invest exists today.

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The plethora of new construction and expansion projects that pipelines have undertaken at cost based rates, however, shows that this concern is unfounded.[3]

Pipelines will continue to file for expansion projects if shippers are willing to sign long-term agreements to support the expansion. Moreover, there is no reason to believe that only "pipeline" capital investment is at play. The most reliable incentive for investment in needed infrastructure by any investor – pipelines included – is the ability to charge market based rates.

3. The Commission's reliance on its decision to retain price caps in the secondary market for electric transmission capacity is misplaced because, unlike the market for short-term natural gas transportation, that market has not been shown to be competitive.

D. Contrary to the Commission's analysis, a bifurcated short-term market under which pipelines rates are capped and competing shipper capacity releases are uncapped may result in higher prices in the uncapped portion of the market than if the entire short-term market were uncapped.

E. Under a properly implemented program to lift price caps on short-term capacity, there is no substance to the Commission's concern that pipelines could withhold capacity. For example, if a pipeline had the pricing freedom to seek both maximum and above-maximum rate bids on available short-term firm capacity, allocative efficiency would be achieved if it could sell the capacity to the highest bidder. If the pipeline did not receive a higher bid than the recourse rate, Commission policy would require the pipeline to allocate the capacity to shippers bidding the maximum rate. As further discussed below, such a

[3] *See, e.g., Natural Gas Pipeline Company of America*, 119 FERC ¶61,346 (2007); *Kinder Morgan Louisiana Pipeline LLC*, 119 FERC ¶¶61,309 (2007); *Rockies Express Pipeline LLC*, 119 FERC 61,069 (2007). [List other member projects]

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bidding procedure for maximum rate bids effectively removes concerns with pipelines withholding capacity.

Commission concerns with potential abuse of pipeline market power if it includes pipeline capacity in its proposal to remove price ceilings in the short-term market could be mitigated by pursuing the same cautious approach that it took in Order No. 637 by experimenting with the pipeline aspect for a two year period**.** This would be consistent with the Commission's proposal to require a staff report on the performance of the program after two years. See NOPR at P 42.

* * *

Finally, for the reasons stated in the NOPR and those previously set out in INGAA's comments in response to the Commission's Notice of Inquiry in related Docket Nos. RM06-21, *et al.*, filed April 11, 2007 ("INGAA NOI Comments"), INGAA supports the Commission's proposal to modify its regulations to facilitate asset management arrangements ("AMAs") and the Commission's proposal to retain the shipper must have title requirement. With respect to AMAs, however, pipelines should not be in the position of policing asset managers. INGAA urges the Commission to specify that releasing shippers take responsibility for identifying AMAs and providing the pertinent information regarding the transaction as described below. See page 21.

With respect to firm storage service, the Commission should clarify that a shipper with firm storage capacity should be permitted to release that capacity subject to conditions

regarding the associated storage inventory without violating the prohibition on tying. See page 21.

II. THE COMMISSION'S PROPOSAL ON SHORT-TERM CAPACITY PRICING

In support of its proposal to lift the ceilings on short-term capacity releases, the Commission offers three rationales. First, the Commission explains how its past initiatives in Order Nos. 636 and 637 have enhanced competition and improved efficiency across the pipeline grid and asserts that those reforms "will help ensure a more competitive market and mitigate the potential for the exercise of market power." NOPR at P at 30. Thus, the Commission points to rules that require pipelines to permit releasing shippers to use flexible point rights and to fully segment their pipeline capacity. According to the Commission, flexible point rights enable "shippers to compete effectively on release transactions with other shippers" and "[s]egmentation further enhances the ability to compete because it enables the releasing shipper to retain the portion of the pipeline capacity it needs while releasing the unneeded portion." NOPR at P 31. The Commission asserts that "[t]he combination of flexible point rights and segmentation increases the alternatives available to shippers looking for capacity." *Id*. (quoting Order No. 637 at 31,300.)

Second, the Commission proceeds to demonstrate that its past experiment with lifting the price ceiling on short-term capacity releases was successful insofar as it demonstrates that the prices "reflect competitive conditions in the industry" (NOPR at P 33). Further, the Commission states that "current data shows that the conditions and that existed at the time of Order No. 637 and during the past experimental period continue in today's marketplace." *Id*. at P 36. Thus, data that the Commission accumulated during the Order No. 637 experiment show that without the price ceiling, prices exceeded maximum pipeline

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rates only during short time periods "and appear to be reflective of competitive conditions in the industry." NOPR at P 34. Prices in excess of maximum pipeline rates accounted for only a small portion of the total releases on pipelines studied (comprising approximately two percent of total transactions and two percent of gas volumes), and accounted for "no more than six or seven percent of transactions during any given month." NOPR at P 35. The Commission observes that, "[a]s one would expect," the releases above the ceiling increased occurred during peak periods. *Id.* To rebut an inference that those prices reflect monopoly pricing, however, the Commission points to the court of appeals decision affirming its prior experiment with releasing the cap, where the court concluded that "brief spikes in moments of extreme exigency are completely consistent with competition, reflecting scarcity rather than monopoly. . . ." NOPR at P 35 (quoting *Interstate Natural Gas Ass'n of America v. FERC*, 285 F.3d 18, 32 (D.C. Cir. 2002)); see also NOPR at P 39 (reiterating point as to later data).

Third, the Commission relies upon continued maximum rate regulation of competing pipeline services to "serve as an additional protection against possible abuses of market power by releasing shippers." NOPR at P 40. In that regard, the Commission observes that pipelines are free to negotiate individualized rates with particular shippers that may be above the maximum tariff rate, but emphasizes that pricing freedom is subject to the condition (inter alia) that the pipeline's maximum tariff rate remains available as a recourse rate for the shipper to prevent pipelines from exercising market power. *Id.* at 41. The Commission reasons that the availability of the pipeline recourse rates (firm and interruptible) prevents a releasing shipper from attempting to exercise market power by charging a price above the competitive level. *Id.*

In its comments in response to the Commission's NOI, INGAA argued that transportation of gas on pipelines has become sufficiently competitive to justify lifting the rate ceiling on the entire short-term capacity market – i.e., including short-term pipeline services -- rather than just on capacity release transactions. See INGAA NOI Comments at 12-14; see also Comments of Spectra Energy Transmission, LLC; Kinder Morgan at 6-16. INGAA also argued that removing the price ceiling only on short-term capacity releases would bifurcate the single marketplace for natural gas transportation services. Based on economic theory acknowledged by the court of appeals in *INGAA, supra,* 285 F. 2d at 36, INGAA argued that if prices for some of the capacity in the marketplace remain subject to a price ceiling while the price ceiling is removed for other forms of capacity, then once the capped capacity has been fully utilized, prices for the uncapped capacity will be higher than they would have been without any price ceiling at all. INGAA NOI Comments at 14-15.

In the NOPR (at PP 46-52), the Commission rejected these arguments on a number of grounds. In the following section, INGAA shows why the Commission's rationale for excluding short-term pipeline services is flawed. INGAA also shows how the Commission's capacity withholding concern can be addressed if pipeline short-term services are included.

III. THE COMMISSION SHOULD AMEND ITS PROPOSAL AND LIFT THE CAP ON THE ENTIRE MARKET FOR SHORT-TERM TRANSPORTATION AND STORAGE CAPACITY

The fundamental rationale proffered by the Commission in support of lifting the rate ceiling on short-term released capacity – the existence of a competitive market for short-term capacity fostered by competition in the industry following the Commission's regulatory reforms that unbundled pipelines – applies to short-term pipeline capacity as well. If the

market is competitive, the identity of the seller should be irrelevant. The sum and substance of the Commission's proposal is to use continued imposition of maximum rate regulation of pipeline short-term capacity as an unnecessary protection against the Commission's market power concerns, with the effect of unfairly handicapping one segment of competitors (pipelines) and the potential for raising prices overall through inefficient pricing.

A. The Market for Short-Term Capacity Pipeline Capacity Is Competitive

INGAA agrees with the Commission's analysis showing the market for short-term capacity to be competitive, based on the Commission's own polices and data from capacity release transactions. See NOPR at PP 23-39; see also INGAA NOI Comments at 12-14. As the Commission acknowledges here (and as early as 2005), "the capacity release program together with the Commission's policies on segmentation, and flexible point rights, has been successful in creating a robust secondary market where pipelines must compete on price." NOPR at P 23 n.28, quoting *Policy for Selective Discounting by Natural Gas Pipelines,* 111 FERC ¶ 61,309 at P 39-41)(2005). Moreover, the empirical data on which the Commission relies does not distinguish between a capacity release segment and a pipeline segment in the single competitive market for short-term transportation. The data showing that the value of short-term transportation was less than the pipeline recourse rates for most of the period for which the data was collected was derived from basis differentials, which reflect the intrinsic value of transportation regardless of whether its source is a pipeline or releasing shippers. Short-term pipeline services are part of the same market as capacity releases. *See also* affidavit of Dr. Edward C. Gallick attached to the Comments of Spectra Energy Transmission, LLC.

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Based on the empirical data collected by the Commission, its own evaluation that there is now a competitive short-term market for pipeline capacity, and recognition that pipelines themselves are competing on price, the Commission has not articulated a reasoned basis for continuing to impose rate ceilings only on pipeline sellers into the short-term market. In short, if the market for short-term pipeline capacity is competitive, all sellers should have the right to sell into that market at market based prices.

B. The Commission's Reliance on its Market Based Rate and Related Policies for Pipelines is Misplaced

In answer to pipeline proposals in the NOI Comments to remove the price ceiling for primary pipeline capacity, the Commission states that "[p]ipelines already have significant ability to use market based pricing." NOPR at P 48. In that regard, the Commission invoked pipelines' ability currently to negotiate rates above the maximum rate. The Commission also pointed out that pipelines may seek market-based rates (subject to a showing that they lack market power) and have the freedom to propose seasonal rates that exceed recourse rates. NOPR at P 48, citing *Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines and Regulation of Negotiated Transportation Services of Natural Gas Pipelines,* 74 FERC ¶ 61,076 (1996) (hereinafter, "Market Based Pipeline Rates"), and Order No. 637 at 31,574-81. From the pipelines' perspective, this pricing freedom is more theoretical than real, and is no match for the pricing freedom proposed for capacity release shippers.

First, to date, the Commission has been very parsimonious in its administration of the market based rate authority, and in particular in its interpretation of the market power test under *Market Based Pipeline Rates*, *supra.* This is particularly the case on pipelines seeking authority for market based transportation rates. The Commission's approval of

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market based pricing has been almost exclusively limited to Greenfield storage projects. Of the approximately half dozen applications for market based transportation rate authority, the Commission has granted only two involving small short haul pipelines: *see KN Interstate Gas Transmission Co*., 76 FERC ¶ 61,134 (1996); and *Rendezvous Gas Services*, L.L.C., 112 FERC ¶ 61,141, at 61,792-94 pp. 26-40 (2005). The Commission has denied every market based rate application by a major interstate pipeline. *See Gas Transmission Northwest Corp*., 119 FERC ¶ 61,288 (2007) ("*GTN*"); *Mississippi River Transmission Corp*., 95 FERC ¶ 61,141 (2001); *Koch Gateway Pipeline Co.,* 85 FERC ¶ 61,013 (1998); *CNG Transmission Corp*., 80 FERC ¶ 61,137 (1997).

Notably, in the recent *GTN* case, the Commission denied market based rate authority for IT service on a single, full-haul path on grounds that the pipeline failed to prove that it lacks market power in each of the three relevant markets (*i.e.,* the transportation path, the origin market, or the destination market). In the *Koch Gateway* proceeding, the Commission reversed an Administrative Law Judge's approval of a market based rate application following a full evidentiary hearing. These and other adverse rulings on market based rates have sent a message to the industry that the hurdles a pipeline must overcome to make a successful absence-of-market-power showing are close to insurmountable.

Moreover, timing is also a factor. A full submission in support of market based rates takes a significant amount of time to prepare, and final resolution can take years. (The *GTN* case took one year, and the *Koch Gateway* proceeding took over three.). Market conditions may change drastically during the course of these proceedings, potentially rendering the exercise academic. Unless a pipeline can define a large enough market in which to "pre-establish" an absence of market power before short-term marketing opportunities arise, it

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will be foreclosed as a practical matter from competing in a particular short-term market on a market based rate basis.

Similarly, the Commission's suggestion that pipelines' ability to negotiate rates that exceed their recourse rate allows them to compete effectively in the short-term market is misplaced. The Commission states that "[r]emoving the price ceiling for short-term capacity release transactions will enable releasing shippers to offer negotiated rate transactions similar to those offered by the pipelines." NOPR at P 41. That is of course true, but the negotiated rate freedom currently enjoyed by pipelines is no match for the pricing freedom that the Commission proposes for capacity release shippers. Procedurally pipelines are at a disadvantage in responding to marketing opportunities because they must file a tariff or service agreement detailing the agreement and are then subject to a 30-day notice requirement granting third parties the right to comment or protest. *See* 18 CFR §§ 154.1(b) and 154.207. The shipper negotiating with the pipeline has the pipeline's ceiling rate available to it as an alternative. By contrast, a pipeline's shipper can choose to offer capacity for release at a minimum price in excess of the pipeline's maximum rate, and Commission approval is not required. Moreover, even under the existing regulations, a shipper paying the recourse rate has the same right to capacity as the shipper willing to pay a higher negotiated rate because of the Commission's policy requiring that bids over the recourse rate be treated as though they were at the recourse rate in allocating the capacity. Under the rule as proposed, pipelines will be at a distinct disadvantage because the releasing shipper will have no corresponding obligation to seek Commission approval or, if there is more than one interested shipper, to allocate the capacity sold at a market based rate as if the shipper were paying the recourse rate.

Nor does the Commission's seasonal pricing policy address the pricing flexibility advantage that shippers will have under the Commission's proposal. See NOPR at P 18 and note 34. Seasonal rates are themselves recourse rates, designed to recover the pipeline's cost of service on an annual basis. Seasonal rates do not present an opportunity for pipelines to charge rates in excess of recourse rates. Moreover, as with market based rates, seasonal rates can only be established through a Section 4 rate case with the attendant time delays. That could reduce the benefit of such rates as the market opportunity may have passed by the time approval is obtained. Additionally, the Commission has typically required cost support behind the derivation of seasonal rates which all pipelines may not be able to provide.

In sum, the various pricing flexibility policies currently in effect for pipelines – market based, negotiated, and seasonal rates – are no substitute for the market pricing freedom that the Commission is proposing for pipeline competitors in the market for short-term capacity. As INGAA urged in response to the Commission's earlier NOI, the Commission should avoid creating a bifurcated market for natural gas transportation under which "primary" capacity held directly by pipelines is subject to substantially different and more stringent rules than capacity held by "virtual pipelines" in the secondary release market.

C. The Commission's Market Power Concerns Are Unwarranted

In rejecting INGAA comments urging that the Commission embrace the entire short-term market in its proposal to lift price ceilings, the Commission also relies on assertions regarding market power. The Commission first maintains that price ceilings on pipeline short-term capacity will be needed as a continuing check on deregulated capacity releases as

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well as pipeline capacity: "[T]he price ceilings on pipeline capacity serve as an effective recourse rate for both pipeline negotiated rate transactions and capacity release transactions to prevent pipelines and releasing shippers from withholding capacity." NOPR at P 49. Second, the Commission asserts that "pipeline capacity is not identical to released capacity, because ownership of the pipeline capacity is likely to be more concentrated than capacity held by shippers for release." NOPR at P 56, citing *INGAA, supra,* 285 F.3d 23-24. Third, the Commission maintains that, because "pipelines are in the best position to expand their own systems," the Commission needs to preserve cost-based rate ceilings for pipelines as an incentive for pipelines to build additional needed capacity. NOPR at P 49. The Commission reasons that with ceiling prices pipelines will have an incentive to invest in new construction, but without them they would have an incentive to create scarcity that increases short-term prices. *Id.*

These concerns are unwarranted. First, given the Commission's own findings as to the existence of competition in the short-term market for natural gas transportation, and the absence of any showing that the existence of competition is confined to capacity release transactions as discussed above, there is no sound basis for preserving cost based pipeline recourse rates as a check on market power. Aside from the existence of a competitive market, the existing regulatory regime provides additional checks in the form of the pipelines' open access tariffs, the opportunity for rate challenges, reporting and posting requirements, and the Commission's enforcement and oversight authority.

There is also little substance to the Commission's concern that pipelines still "own" more pipeline capacity than their firm shippers. This view is based on a pre-restructuring, pre-open access view of the industry, and in any case is not based on any contemporary

empirical study of pipeline market power. Some segments of pipeline capacity are fully contracted for long periods of time, thus removing entirely a pipeline's ability to withhold capacity to raise prices. In fact, the capacity that a pipeline has available for sale in the short-term market is typically a relatively small portion of the overall short-term firm capacity available on that pipeline. Moreover, since property is a "bundle of rights," the pertinent focus in this regard should not be on formal ownership, but rather on the entity that *controls* access to or use of the capacity. *See Dolan v. City of Tigard*, 512 U.S. 374, 384 (1994) ("[T]he right to exclude others" is "`one of the most essential sticks in the bundle of rights that are commonly characterized as property'" (quoting *Kaiser Aetna v. United States*, 444 U.S. 164, 176 (1979)); *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 435 (1982) (including "use" as one of the "[p]roperty rights in a physical thing").

The is no merit to the notion that maintaining cost based recourse rates for pipelines is required in order to preserve an incentive for pipelines to construct needed pipeline infrastructure. There are a number of considerations that rebut that assumption. First, given that the short-term market is competitive as discussed above, it runs counter to the general presumption that market based rates send the proper signals as to whether new pipeline construction is needed and can be constructed economically.

Second, pipelines actually compete to build new capacity. Pipelines have constructed numerous new and expansion projects at cost-based rates. For example, three pipelines were in competition to build the pipeline that became Gulfstream Natural Gas System, L.L.C. in Florida, and currently there are five pipeline proposals to build projects to transport gas supply into the Rocky Mountain region that will be made available by the Rockies Express Pipeline Project.

Third, there is no reason to believe that only "pipeline" capital investment is at play in making such decisions. If pipelines withhold capacity, there is no reason to assume that non-pipeline investment will not fill a void. The pipeline industry has attracted a number of new investors recently and there is no reason to believe that those investors will not meet the need for new capacity if the incumbent pipeline does not do so. Even assuming that the Commission must rely on pipeline investment, decisions to construct new pipeline are grounded in long term shipper commitments to pay fixed demand charges; neither pipelines nor any other infrastructure investor would base an investment decision of the magnitude required to construct a pipeline on mere pricing in the short-term market.

Moreover, there will be no scarcity of capacity or need for new capacity to be built unless the pipeline is sold out on a firm basis. If a pipeline has sold out all of its capacity, the pipeline will have no short-term firm capacity to sell in any case. In that situation, the only capacity the pipeline can sell is interruptible service, which is generally inferior to the firm capacity available through capacity release.

Finally, the Commission's reliance (NOPR at P 49, note 56) on its parallel rulemaking in the electric power industry in Docket No. 890 is misplaced.[4] There the Commission also relied on the preservation of cost-based rates maintained by electric power transmission owners as a check on market power when it authorized market-based pricing of transmission in the "secondary" market. Order No. 890 at PP 808-9. There is, however, a critical difference between the industries. Here, the Commission has already conducted an experiment in the secondary market for short-term natural gas transportation, and has concluded that it is competitive. In Order No. 890, by contrast, the Commission found that

[4] *Preventing Undue Discrimination and Preference in Transmission Service*, FERC Stats. & Regs., ¶ 31,241 at P 808-9 (2007).

electric power capacity reassignment "has failed to develop into a competitive alternative to primary capacity." *Id*. at P 808.

D. Contrary to the Commission's View, a Bifurcated Short-term Capacity Market Has the Potential for Increasing Prices in the Deregulated Capacity Release Market

In response to argument by INGAA and individual pipelines that bifurcating the short-term market by deregulating only the capacity release transactions would have the unintended effect of producing a higher market clearing price than would otherwise be the case if the entire market were deregulated, the Commission asserted that the premise of the pipelines' argument was wrong (NOPR at P 51):

> The premise of the pipelines' argument is that continued price controls on the pipeline's sales of short-term capacity will enable shippers placing a lower value on the capacity to "use up" some of the supply, thereby reducing the amount of capacity available for purchase by shippers placing a higher value on the capacity. This premise is incorrect. Short-term pipeline capacity is sold as interruptible transportation; therefore, firm capacity held by shippers will have scheduling priority over the pipeline's interruptible capacity. In essence, pipeline interruptible service is derived from existing shippers' decision not to use or release their firm capacity or from unsold pipeline capacity. Thus, even if a shipper placing a relatively low value on the capacity has a higher position on the pipeline's queue for price-controlled interruptible transportation, it is not guaranteed that it can acquire (or "use up") that capacity, leading to the supposed higher market clearing price. A firm shipper could always release its unused firm capacity to a replacement shipper who places a higher value on that capacity, thereby displacing the lower-value interruptible shipper.

The Commission's observation that pipeline short-term capacity is interruptible and therefore inferior to firm released capacity is a partial answer to the argument that a bifurcated market will produce higher prices in the regulated portion than would otherwise be the case. There are, however, complications. Short-term pipeline capacity is not always interruptible. Unsubscribed pipeline capacity can be sold on a firm basis during periods of

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peak demand, and would, if treated on a par with released capacity, compete head to head. Additionally, released capacity is not always firm in the sense that the releasing shipper often includes recall rights as a condition of the release. In that case, a replacement shipper is not guaranteed use of the capacity during the recall period and, in that sense, its service may also be viewed as interruptible. If the rate for that short-term firm pipeline capacity is capped, as the Commission proposes, the same pricing inefficiency described above and in INGAA's NOI Comments can reasonably be expected to occur. *See also INGAA, supra,* 285 F.3d at 35-36 ("The presence of the extra unsatisfied higher-value demand alters the demand-supply ratio in the uncontrolled market, which will therefore clear at a higher price than if the entirety were uncontrolled.").

The Commission suggests that this is not a problem because "even in the context of firm short-term pipeline capacity, the scenario posited by the pipelines would not result in higher market clearing prices as long as arbitrage exists." NOPR at P 52. The Commission posits that the shipper with capped pipeline capacity can simply turn around and sell it as capacity release at market prices. The extent to which such efficient arbitrage will exist to prevent the pricing inefficiencies posited by INGAA (and the court of appeals) is in any case hypothetical. That buyers would have to go through additional steps to achieve pricing efficiency, however, is clear, and those extra steps will of course have costs. The problems presented by a bifurcated market are not so easily circumvented.

E. Including Short-term Pipeline Services Will Not Result in Pipelines Withholding Capacity.

There is a way to include pipeline short-term capacity, which addresses the Commission's concern regarding the pipeline withholding capacity, as part of the Commission's initiative. For example, a bidding procedure for pipeline maximum rate bids

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could be implemented as part of the Commission's proposal. Specifically, when a pipeline receives a maximum rate bid on available short-term firm capacity (i.e., one year or less), the pipeline would have the right (*but not the obligation*) to post the maximum rate bid for further bidding. To the extent a third party shipper places a higher value on the capacity, the pipeline would be required to allocate the capacity to that shipper. If the pipeline does not receive a bid higher than the maximum rate bid, the pipeline would be required to allocate the capacity to the original maximum rate bidder. Of course, if the pipeline receives a maximum rate bid at the same time as an above-maximum bid, the pipeline would have the right to allocate the capacity to the highest bidder. In this way, the pipeline is not withholding capacity. The Commission should consider such a bidding procedure as a means to allow short-term pipeline capacity to compete on the same terms as capacity release.

Finally, Commission concerns with potential abuse of pipeline market power if it includes pipeline capacity in its proposal to remove price ceilings in the short-term market could be mitigated by pursuing the same cautious approach that it took in Order No. 637 by experimenting with the pipeline aspect for a two year period**.** This would be consistent with the Commission's proposal to require a staff report on the performance of the program after two years. See NOPR at P 42.

IV. OTHER ISSUES

For the reasons stated in the NOPR and those previously set out in INGAA's comments in response to the Commission's NOI, INGAA supports the Commission's proposal to modify its regulations to facilitate asset management arrangements (AMAs) and

the Commission's proposal to retain the shipper must have title requirement. INGAA has only the following suggestions.

A. Policing Asset Manager Compliance

With respect to AMAs, pipelines already have a substantial role in administering the Commission's capacity release program (see INGAA NOI Comments at 4-6). Pipelines should not, however, have the responsibility for policing asset managers in complying with the Commission's proposed reforms of the program. Accordingly, the Commission should specify that pipelines may use a "check the box" approach for a releasing shipper to identify the capacity release as an asset management arrangement. Pipelines would be responsible for posting offers submitted by releasing shippers using the terms and conditions as provided to them.

B. Conditional Releases of Storage Capacity

The Commission seeks comment on whether a shipper with firm storage capacity should be permitted to release that capacity subject to conditions regarding the associated storage inventory without violating the prohibition on tying. See NOPR at P 82. The unique character of storage service justifies permitting such conditional releases. Opportunities for shippers to release storage capacity would be limited significantly without the ability to set requirements concerning the sale or repurchase of the gas in storage or inventory levels upon the expiration of the release. Such conditions relate directly to the releasing shipper's utilization of its service, and should therefore not be viewed as extraneous to the transaction or unreasonable tying arrangements.

CONCLUSION

INGAA urges the Commission to lift the cap on the entire market for short-term natural gas transportation and storage, and to reform its capacity release regulations in accordance with the considerations discussed above.

Respectfully submitted,

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