

LEXSEE 88 FERC 61227

Certification of New Interstate Natural Gas Pipeline Facilities

Docket No. PL99-3-000

FEDERAL ENERGY REGULATORY COMMISSION - COMMISSION

88 F.E.R.C. P61,227; 1999 FERC LEXIS 1888

STATEMENT OF POLICY

September 15, 1999

**HISTORY:** **[\*\*1]** As Amended October 8, 1999.

**PANEL:**

Before Commissioners: James J. Hoecker, Chairman; Vicky A. Bailey, William L. Massey, Linda Breathitt, and Curt Hebert, Jr.

**OPINION:**

**[\*61,736]**

In the Notice of Proposed Rulemaking (NOPR) in Docket No. RM98-10-000 n1 and the Notice of Inquiry (NOI) in Docket No. RM98-12-000, n2 the Commission has been exploring issues related to the current policies on certification and pricing of new construction projects in view of the changes that have taken place in the natural gas industry in recent years.

n1 Notice of Proposed Rulemaking, Regulation of Short-term Natural Gas Transportation Services, 63 Fed. Reg. 42982, 84 FERC P61,087 (1998).

n2 Notice of Inquiry, Regulation of Interstate Natural Gas Transportation Services, 63 Fed. Reg. 42974, 84 FERC P61,087 (July 29, 1998).

In addition, on June 7, 1999, the Commission held a public conference in Docket No. PL99-2-000 on the issue of anticipated natural gas demand in the northeastern United States over the next **[\*\*2]** two decades, the timing and the type of growth, and the effect projected growth **[\*61,737]** will have on existing pipeline capacity. All segments of the industry presented their views at the conference and subsequently filed comments on those issues.

Information received in these proceedings as well as recent experience evaluating proposals for new pipeline construction persuade us that it is time for the Commission to revisit its policy for certifying new construction not covered by the optional or blanket certificate authorizations. n3 In particular the Commission's policy for determining whether there is a need for a specific project and whether, on balance, the project will serve the public interest. Many urge that there is a need for the Commission to authorize new pipeline capacity to meet the growing demand for natural gas. At the same time, others already worried about the potential for capacity turnback, have urged the Commission to be cautious because of concerns about the potential for creating a surplus of capacity that could adversely affect existing pipelines and their captive customers.

n3 This policy statement does not apply to construction authorized under 18 CFR Part 157, Subparts E and F.

**[\*\*3]**

Accordingly, the Commission is issuing this policy statement to provide the industry with guidance as to how the Commission will evaluate proposals for certifying new construction. This should provide more certainty about how the Commission will evaluate new construction projects that are proposed to meet growth in the demand for natural gas

at the same time that some existing pipelines are concerned about the potential for capacity turnback. In considering the impact of new construction projects on existing pipelines, the Commission's goal is to appropriately consider the enhancement of competitive transportation alternatives, the possibility of overbuilding, the avoidance of unnecessary disruption of the environment, and the unneeded exercise of eminent domain. Of course, this policy statement is not a rule. In stating the evaluation criteria, it is the Commission's intent to evaluate specific proposals based on the facts and circumstances relevant to the application and to apply the criteria on a case-by-case basis.

#### I. Comments Received on the NOPR

In the NOPR the Commission explained that it wants to assure that its policies strike the proper balance between the enhancement [\*\*4] of competitive alternatives and the possibility of over building. The Commission asked for comments on whether proposed projects that will establish a new right-of-way in order to compete for existing market share should be subject to the same considerations as projects that will cut a new right-of-way in order to extend gas service to a frontier market area. Also, in reassessing project need, the Commission said that it was considering how best to balance demonstrated market demand against potential adverse environmental impacts and private property rights in weighing whether a project is required by the public convenience and necessity.

The Commission asked commenters to offer views on three options: One option would be for the Commission to authorize all applications that at a minimum meet the regulatory requirements, then let the market pick winners and losers. Another would be for the Commission to select a single project to serve a given market and exclude all other competitors. Another possible option would be for the Commission to approve an environmentally acceptable right-of-way and let potential builders compete for a certificate.

In addition, the Commission asked commenters [\*\*5] to consider the following questions: (1) Should the Commission look behind the precedent agreement or contracts presented as evidence of market demand to assess independently the market's need for additional gas service? (2) Should the Commission apply a different standard to precedent agreements or contracts with affiliates than with non-affiliates? For example, should a proposal supported by affiliate agreements have to show a higher percentage of contracted-for capacity than a proposal supported by non-affiliate agreements, or, should all proposed projects be required to show a minimum percent of non-affiliate support? (3) Are precedent agreements primarily with affiliates sufficient to meet the statutory requirement that construction must be required by the public convenience and necessity, and, if so, (4) Should the Commission permit rolled-in rate treatment for facilities built to serve a pipeline affiliate? (5) Should the Commission, in an effort to check overbuilding and capacity turnback, take a harder look at proposals that are designed to compete for existing market share rather than bring service to a new customer base, and what particular criteria should be applied in [\*\*6] looking at competitive applications versus new market applications? (6) Should the Commission encourage pre-filing resolution of landowner issues by subjecting proposed projects to a diminished degree of scrutiny where the project sponsor is able to demonstrate it has obtained all necessary right-of-way authority? (7) Should a different standard be applied to project sponsors [\*61,738] who do not plan to use either federal or state-granted rights of eminent domain to acquire right-of-way?

##### A. Reliance on Market Forces to Determine Optimal Sizing and Route for New Facilities

PG&E, Process Gas Consumers (PGC), Tejas Gas, Washington Gas, Columbia, Market Hub Partners, and Ohio PUC agree that the Commission should continue to let the market decide which projects to pursue. PG&E states that the Commission should authorize all projects that meet minimum regulatory requirements, looking at whether the project will serve new or existing markets, the firmness of commitments and environmental and property right issues. PGC urges the Commission to refrain from second guessing customers' decisions. Tejas suggests that the Commission rely on the market to the maximum extent; regulatory changes that affect [\*\*7] risk/reward allocation will increase regulatory risk and deter new investment. Washington Gas suggests letting the market decide on new construction with market based rates subject only to environmental review and landowner concerns. Columbia comments that it would not be economically efficient to protect competitors from the competition created by new capacity. Market Hub Partners specifies that, when there is no eminent domain involved, the focus should be on competition, not protecting individual competitors from overbuilding. Ohio PUC supports authorizing all applications for new capacity certification which meet the minimum regulatory requirements. Ohio PUC does not support approving a single pipeline's application while excluding all others.



The Regulatory Studies Program of the Mercatus Center, George Mason University suggests allowing projects to be proposed with no certification requirements, but allowing competitors to challenge the need. Investors would be at risk for all investments. Tejas proposes holding pipelines at risk for reduced throughput, thereby avoiding shifting the risk to customers.

On the issue of overbuilding, Millennium, Enron, PGC, Columbia, and Wisconsin [\*\*8] PSC disagree with the presumption that overbuilding must be avoided. Millennium asserts that all competitive markets have excess capacity. Enron urges the Commission to be receptive to overbuilding in areas of rapid growth, difficult construction, and environmental sensitivity. PGC agrees that some capacity in excess of initial demand may make environmental and economic sense in that it will reduce the need for future construction, but argues that the pipelines be at risk for those facilities. Columbia alleges that the concern about overbuilding is misguided. Wisconsin PSC contends that concerns of overbuilding should not operate to limit the availability of competitive alternatives to customers currently without choices of pipeline provider. Wisconsin PSC believes the elimination of the discount adjustment mechanism and the imposition of reasonable at risk provisions for new construction will deter pipelines from overbuilding.

On the other hand, UGI recommends that overbuilding be minimized. UGI states that the Commission should ensure a reasonable fit between supply and demand. The Commission should limit certification of new projects to ones which demonstrate unmet demand or demand [\*\*9] growth over 1-3 years.

Coastal stresses that competition should not be the only or primary factor in deciding the public convenience and necessity.

Amoco contends that, if the Commission chooses the right-of-way, it will in many cases have chosen the parties that will ultimately build the pipeline. Amoco urges the Commission not substitute its judgement for that of the marketplace unless there are overwhelming environmental concerns. Tejas also objects to the option of the Commission approving an environmentally acceptable right-of-way and letting potential builders compete for a certificate because it believes it would be difficult for the Commission to implement.

Colorado Springs supports the concept of having the Commission select a single project in a given corridor rather than letting the market pick winners and losers.

PGC and Ohio PUC recommend that the Commission authorize all construction applications meeting certain threshold requirements, leaving the market to decide winners and losers. PGC urge the Commission to facilitate construction of new pipelines that will increase the potential for gas flows. Under no circumstances should the Commission deny a certificate based [\*\*10] on a complaint by an LDC or a competing pipeline that new construction will hurt their market position or ability to recover costs. The Commission should not afford protection to traditional suppliers or transporters by constraining the development of new pipeline capacity.

PGC believes that only in unusual situations, where insuperable environmental barriers cannot be resolved through normal mitigation measures, should the Commission select an acceptable right-of-way. Ohio PUC does not support approving a single pipeline's application while excluding all others. Ohio PUC recommends having market forces guide construction projects unless or until obvious shortcomings begin to emerge. In such instances, the option of designating a single right-of-way with competition [\*61,739] for the certificate could be used to spur needed construction.

#### B. Reliance on Contracts to Demonstrate Demand

A number of parties comment that there is no reason to change the current policy regarding certificate need (AlliedSignal, Millennium, Southern Natural, Tejas, Williston, Columbia). National Fuel Gas Supply believes the Commission should keep shipper commitment as the test because it is more accurate than market [\*\*11] studies. National Fuel Gas Supply further believes the Commission's present reliance on market forces to establish need, and its environmental review process, form the best approach to reviewing certificate applications. Foothills agrees, but states that a new, flexible regulatory structure for existing pipelines is needed. Indicated Shippers also wants to keep the current policy, but stresses that expedition in processing is needed to lower entry barriers.

Amoco, Consolidated Natural, and Columbia urged the Commission to continue requiring sufficient binding long-term contracts for firm capacity. Millennium and Tejas stated that there is no need to develop different tests for different markets. Columbia also argued that there is no need to look behind contracts. Williams argues that the Commission should not second guess contracts or make an independent market analysis. Williston alleges that reviewing the firmness of private contracts is ineffectual and futile. Market Hub Partners cautions the Commission not to substitute



its judgement for that of the marketplace.

PGC argues that there should be no change to current policy where construction affects landowners. Eminent domain is [\*\*12] a necessary tool to delivering clean burning natural gas to growing markets; no individual landowners should be given a veto over pipeline construction. PGC adds that the absence of prefilings right-of-way agreements does not mean that a project is less good or necessary or should be treated more harshly. Southern Natural, Millennium, and National Fuel Gas Supply agree that no market preference should be given for projects that do not use eminent domain. National Fuel Gas Supply agrees that such a preference would tilt the power balance to landowners. Millennium argues that the Commission should not establish certificate preferences for pipelines that do not require eminent domain; such preferences are not needed because a pipeline that does not want to use eminent domain can already build projects under Section 311.

On the other hand, Amoco, El Paso/Tennessee, ConEd, and Wisconsin PSC recommend modifying the current policy. El Paso/Tennessee recommend that the Commission look behind all precedent agreements to see if real markets exist. ConEd suggests considering forecasts for market growth; if there is a disparity with the proposal, the Commission should look at all circumstances. [\*\*13] Wisconsin PSC urges the Commission to consider market saturation and growth prospects by looking at market power (HHIs) and the degree of rate discounting in a market. Amoco suggests that the Commission analyze all relevant data. Peco Energy believes the current Commission policy, which provides for minimal market justification for authorizing construction of incremental facilities, coupled with its presumption in favor of rolled-in rate treatment, has contributed to discouraging existing firm shippers from embracing longer term capacity contracts.

Consolidated Natural recommends creating a settlement forum for market demand and reverse open season issues. Washington Gas urges the Commission to adopt an open entry, "let the market decide" policy. IPAA supports a need analysis focusing on the ability of existing capacity to handle projected demand. IPAA alleges that the overall infrastructure is already in place to supply current demand projections.

Some commenters support a sliding scale approach to determine need. ConEd states that the Commission should determine need on a case-by-case basis, using different standards for large or small projects. Enron advocates use of a sliding [\*\*14] scale, requiring more market support for projects with more landowner and/or environmental impact. Enron supports requiring no market showing for projects using existing easements or mutually agreed upon easements. Enron also suggests, in addition to requiring that at least 25% of the precedent agreements supporting a project be with non-affiliates, that the Commission relax its market analysis if 75% or more of those agreements are with non-affiliates. Enron would require more market data for an affiliate-backed project. American Forest & Paper would allow negotiation of risk if there is no subsidy by existing customers. Sempra and UGI urge the Commission to look at whether projects serve identifiable, new or growing markets. NARUC states that each state is unique and that the Commission should consider those differences. Market Hub Partners believes that a project which is at risk, requires little or no eminent domain authority, and has potential to bring competition to a market that is already being served by pipelines and storage operators with market power should be expedited.

The development in recent years of certificate applicants' use of contracts with affiliates to demonstrate [\*\*15] market support for projects has generated opposition from affected landowners [\*61,740] and competitor pipelines who question whether the contracts represent real market demand. ConEd, Ohio PUC, and Enron believe that a different standard should be applied to affiliates. ConEd argues that the at risk condition is inadequate when a pipeline serves a market served by an affiliate; risk is shifted. Ohio PUC states that pipelines should shoulder the increased risk and that the Commission should look behind contracts with affiliates. Enron would require more market data for affiliate-backed projects and would require that all projects be supported by precedent agreements at least 25% of which are with non-affiliates.

Nevertheless, most of the commenters support applying the same standard to contracts for new capacity with affiliates as non-affiliates. Amoco, Coastal, Millennium, National Fuel, Southern Natural, Tejas, Texas Eastern, Columbia, Market Hub Partners, El Paso/Tennessee, and PGC all support applying the same standard to affiliates as non-affiliates. Market Hub argues that a contract is a contract; treating affiliates differently would be in the interest of incumbent monopolists. El Paso/Tennessee [\*\*16] agree that affiliate precedent agreements are sufficient as long as they are supported by market demand. PGC agrees that the same standard should apply as long as the proposed capacity is offered on a non-discriminatory basis to all in an open season. Amoco makes an exception for marketing affiliates, arguing that they do not represent new demand. Columbia also makes an exception for affiliates that are



created just to show market for a project.

Other parties also offered comments on affiliate issues. PGC recommends addressing affiliate issues on a case-by-case basis. Exxon supports offering comparable deals to non-affiliates. If there is insufficient capacity, it should be prorated. AGA supports prohibiting discount adjustments connected with new construction by pipelines or affiliates. National Fuel Gas Supply and Tejas support permitting rolled-in rates for facilities to serve affiliates. PGC argues that there should be no presumption of rolled in rates for affiliates.

The commenters also express concern with the current policy's effect on existing pipelines and their captive customers when the Commission approves pipeline projects proposed to serve the same market. In those cases, [\*\*17] they believe that need should be measured differently by, for example, assessing the impact on existing capacity or requiring a strong incremental market showing and more scrutiny of the net benefits. They urge the Commission to balance all the relevant factors before issuing a certificate. A number of parties argued that need should be measured differently when a project is proposed to serve an existing market. UGI urges requiring a strong market showing for such projects. Coastal proposes that the Commission fully integrate the standards announced by the courts<sup>n4</sup> with its certificate construction policies, balancing all the relevant factors including the ability of the existing provider to provide the service. El Paso/Tennessee would require more scrutiny of the net benefit. Sempra would require that, prior to construction, all shippers be given the opportunity to turn back capacity. Similarly, Texas Eastern would require the pipeline to use unsubscribed capacity before construction (e.g., a reverse auction).

n4 Citing *FPC v. Transcontinental Gas Pipeline Corp.*, 365 U.S. 1, 23 (1961) and *Scenic Hudson Preservation Conference v. FERC*, 354 F.2d. 608, 620 (2nd Cir. 1965)

[\*\*18]

Other commenters oppose a policy requiring a harder look at projects proposed to serve existing markets. They maintain that market demand for service in order to escape dependence on a dominant pipeline supplier should be accorded the same weight as demand by new incremental load growth. They contend that the benefits of competition and potentially lower gas prices for consumers should control over claims that an existing pipeline needs to be insulated from competition because its revenues may decrease. National Fuel Gas Supply, PGC, Florida Cities, Market Hub Partners, and Southern Natural in particular object to having different policies for new or existing pipelines. National Fuel Gas Supply contends that generally the policies on new construction and existing pipelines should match. PGC opposes any policy that protects incumbents by requiring a harder look at projects proposed to serve existing markets rather than new demand. Many existing markets have unmet demand. Likewise, Florida Cities is concerned that the NOPR is intended to elicit a new policy where the import and influence of competition is downplayed to minimize or eliminate the risk of unsubscribed capacity on existing [\*\*19] pipelines. Florida Cities supports pipeline-on-pipeline competition as a primary factor in determining which new capacity projects receive certificate authority and are constructed. Florida Cities believes that additional pipeline competition would benefit customers and any generic policy that would decrease or inhibit pipeline competition would not be in the best interest of the consumers the Commission is obliged to protect. Market Hub Partners urges the Commission to attempt to limit market incumbents' ability to forestall competition by defeating the efforts of new market entrants [\*61,741] to build or operate new capacity. Market Hub Partners contend that incumbents protest on the basis of project safety and environmental concerns when they are primarily concerned with their own welfare and market share. Southern Natural contends the NGA does not permit a rule disfavoring projects that enhance competitive alternatives. Taking a harder look at competitive proposals would effect a preference for monopoly, clearly not endorsed by the NGA or the Courts of Appeal.

Wisconsin Distributor Group believes that meaningful pipe-on-pipe competition can only exist where there are choices among or between [\*\*20] pipelines and unsubscribed firm capacity exists. Wisconsin Distributor Group argues the Commission should view favorably new pipeline projects that propose to create competition by introducing an alternative pipeline to markets where no choices exist. Wisconsin Distributor Group contends the Commission's policy should not be driven by self-protective arguments but by the need for competitive alternatives. Wisconsin Distributor Group supports the Commission's analysis in *Alliance* and *Southern* because it considers the benefits of competition and potentially lower gas prices for consumers as controlling over claims that an existing pipeline needs to be insulated from competition because its revenues may decrease. Market demand for service in order to escape dependence on a dominant pipeline supplier should be accorded the same weight as demand by new incremental load growth.



UGI, Sempra, and El Paso/Tennessee would require assessing the impact on existing capacity. Sempra states that if existing rates are below the maximum rate, new capacity may not be needed. Sempra adds that the Commission should look at whether expansion capacity can stand on its own without rolled-in treatment. Texas [\*\*21] Eastern believes the Commission must consider how best to use existing unsubscribed capacity and capacity that has been turned back to pipelines.

### C. The Pricing of New Facilities

A number of commenters submit that the existing presumption in favor of rolled-in rates for pipeline expansions sends the wrong price signals with regard to pricing new construction. They urge the Commission to adopt policies such as incremental pricing for pipeline projects or placing pipelines at risk for recovery of the costs of construction. They submit that such a policy would reveal the true value of existing capacity and properly allocate costs and risks. A number of parties also raised issues concerning rate design in general, but the Commission is deferring for now consideration of those kinds of issues which also affect the Commission's policies for existing pipelines in order to focus on issues concerning the certification of new pipeline construction.

AGA, ConEd, and Michigan Consolidated stress the importance of ensuring the right price signals. AGA urges the Commission to adopt policies that reveal the true value of existing capacity. ConEd states that rate policies should send proper price [\*\*22] signals by properly allocating costs and risks.

AGA contends that the Commission's certification policies should protect recourse shippers. AGA and BG&E recommend that the Commission ensure that pipelines are not able to impose the costs of new capacity or the costs of consequent unsubscribed existing capacity on recourse shippers. Amoco asserts pipelines should be at risk for unsubscribed capacity. Similarly, AGA and Philadelphia Gas Works urge the Commission to ensure that pipelines are at risk for unsubscribed capacity relating to construction projects by the pipeline or its affiliate. However, Tejas believes that treatment of any under recovery must address the unique circumstances of deepwater pipelines.

APGA argues that, if the Commission allows initial rates based on the life of the contract rather than the useful life of facilities, the Commission must at least require a uniform contract with the same terms and conditions for all customers involved in the expansion.

The Williams Companies recommend that all new capacity be subject to market-based rates. The Williams Companies argue that, for new capacity priced on an incremental basis rather than a rolled-in basis, competitive [\*\*23] circumstances in the industry support the use of market-based rates and terms of service.

AlliedSignal contends depreciation should be based on the life of the facilities not the life of a contract. If the Commission were to promulgate a general rule, it should state that depreciation rates for pipeline facilities in rate and certificate cases should be set at 25 years unless factors are brought to the Commission's attention justifying a lesser or longer time period. NGSa believes that the Commission's current depreciation methodology is appropriate. NGSa also urges that the appropriate asset life of new facilities be determined when the facilities are constructed and adhered to for the life of the asset. On the other hand, the Williams Companies point out that market-based rates would negate the need for the Commission to approve depreciation rates.

Coastal believes pipelines should have the flexibility to address new facility costs in certificate applications and in rate cases. The Commission should not establish hard and fast rules as to how a facility should be treated in a pipeline's rates over its entire life. Rather, costs should be dealt with in accordance with [\*61,742] Commission [\*\*24] policies from time to time in pipeline rate cases.

Enron Pipelines contend that the rate treatment for capacity additions should continue to be determined on a case-by-case basis using the system benefits test.

Louisville contends that the Commission should address the question of whether its pricing policies for new capacity provide appropriate incentives at the same time as it considers auctions and negotiated rates and services and that all of these issues should be the subject of a new NOPR.

PGC suggest that initial rates be based on a presumed level of contract commitment (e.g., 80-90%) so the pipeline bears the risks of uncommitted capacity but reaps a reward if it sells at undiscounted rates. Another option would be for the Commission to put at risk only that portion of the proposed facilities for which the pipeline has not obtained firm contracts of a minimum duration. Where an existing pipeline constructs new facilities, PGC support the Commission's



current policy favoring rolled-in rates if certain conditions are met.

Williston Basin argues that fixed rates for long-term contracts would create a relatively risk-free contract for shippers while creating a total-risk contract [\*\*25] for pipelines.

Arkansas, IPAA, Indicated Shippers, National Fuel Gas Supply, NGSA, Peoples Energy, PGC, and the Williams Companies support the Commission's current policy with its presumption in favor of rolled-in pricing for new capacity only when the impact of new capacity is not more than a 5% increase to existing rates and results in system-wide benefits. AGA, Amoco, IPAA, Philadelphia Gas Works, PGC, and UGI recommend that the Commission more rigidly apply its pricing policy and more closely review claims pertaining to the 5% threshold test and/or system benefits. Nicor urges that pipelines should not be allowed to segment construction with the goal of falling below the 5% pricing policy threshold.

APGA and Consolidated Edison recommend that the Commission adopt a presumption of incremental pricing for pipeline certificate projects. APGA would allow limited exceptions such as when the project would lower rates to existing customers or when the benefits of the project would fully offset the costs of the roll-in. Koch Gateway and Pennsylvania Consumer Advocate also recommend incremental pricing for new capacity.

Arkansas and Brooklyn Union contend that pipelines should be at risk [\*\*26] for the recovery of the costs of incremental facilities. Brooklyn Union urges the Commission to eliminate the presumption in favor of rolled-in pricing for new capacity and require pipelines to show the benefits of each new project are proportionate to the total rate increase sought.

El Paso/Tennessee recommend that only fully subscribed projects with revenues equaling or exceeding project costs and supported by demonstrated market need should be eligible for rolled-in rates. El Paso/Tennessee believe that projects intended to compete for existing market should not be eligible for rolled-in rates.

New York questions the 5% presumption for rolled-in pricing and argues that a move away from rolled-in pricing would create competitive markets for new pipeline construction.

AlliedSignal believes pipelines should be at risk for costs relative to new services prior to filing a new rate case. In the new rate case, the burden should be on the pipeline to justify the proper allocation of costs.

Amoco suggests that the pipeline and customer be allowed to enter into any agreement that does not violate existing regulations or statutory requirements, but they must explicitly apportion any risk [\*\*27] between themselves.

The Illinois Commerce Commission believes this issue needs more research and should not be addressed until state regulators are consulted further.

Market Hub Partners and PGC contend that rolled-in rate treatment should not be granted for facilities solely or principally being constructed on the basis of affiliate precedent agreements. On the other hand, Millennium asserts that affiliates and non-affiliates should be treated alike with respect to rate design. Also, Southern Natural argues that the fact that an affiliate subscribed for capacity on new facilities cannot alone preclude rolled-in pricing for those facilities; the Commission must leave to individual cases the issue of whether to price facilities on a rolled-in or incremental basis.

Nicor argues that the Commission cannot, in a competitive marketplace, evaluate the enhancements claimed by the pipeline to determine whether new construction should be incrementally priced or receive rolled-in rate treatment. Instead of imposing rolled-in rate treatment on the entire system, the Commission should allow individual "old" shippers to decide whether the supposed benefits are worth the costs.

Pipeline Transportation [\*\*28] Customer Coalition contends the existing regulatory process does not reflect a reasonable risk-reward balance between industry segments, asserting that pipeline rates are too high given their relatively low risk exposure. [\*61,743]

## II. Certificate Policy Goals and Objectives

The comments present a variety of perspectives and no clear consensus on a path the Commission should follow. Nevertheless, the starting point for the Commission's reassessment of its certificate policy is to define the goals and objectives to be achieved. An effective certificate policy should further the goals and objectives of the Commission's



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natural gas regulatory policies. In particular, it should be designed to foster competitive markets, protect captive customers, and avoid unnecessary environmental and community impacts while serving increasing demands for natural gas. It should also provide appropriate incentives for the optimal level of construction and efficient customer choices.

Commission policy should give the applicant an incentive to file a complete application that can be processed expeditiously and to develop a record that supports the need for the proposed project and the public benefits to be obtained. [\*\*29] Commission certificate policy should also provide an incentive for applicants to structure their projects to avoid, or minimize, the potential adverse impacts that could result from construction of the project.

The Commission intends the certificate policy introduced in this order to provide an analytical framework for deciding, consistent with the goals and objectives stated above, when a proposed project is required by the public convenience and necessity. In some respects this policy is not a significant change from the kind of analysis employed currently in certificate cases. By stating more explicitly the Commission's analytical framework, the Commission can provide applicants and other participants in certificate proceedings a better understanding of how the Commission makes its decisions. By encouraging applicants to devote more effort before filing to minimize the adverse effects of a project, the policy gives them the ability to expedite the decisional process by working out contentious issues in advance. Thus, this policy will provide more certainty about the Commission's analytical process and provide participants in certificate proceedings with a framework for shaping [\*\*30] the record that is needed by the Commission to expedite its decisional process.

### III. Evaluation of Current Policy

#### A. Current Policy

Section 1(b) of the Natural Gas Act (NGA) gives the Commission jurisdiction over the transportation of natural gas in interstate commerce and the natural gas companies providing that transportation. n5 Section 7(c) of the NGA provides that no natural gas company shall transport natural gas or construct any facilities for such transportation without a certificate of public convenience and necessity issued by the Commission. n6

n5 15 U.S.C. § 717.

n6 15 U.S.C. § 717h.

In reaching a final determination on whether a project will be in the public convenience and necessity, the Commission performs a flexible balancing process during which it weighs the factors presented in a particular application. Among the factors that the Commission considers in the balancing process are the proposal's market support, economic, operational, [\*\*31] and competitive benefits, and environmental impact.

Under the Commission's current certificate policy, an applicant for a certificate of public convenience and necessity to construct a new pipeline project must show market support through contractual commitments for at least 25 percent of the capacity for the application to be processed by the Commission. An applicant showing 10-year firm commitments for all of its capacity, and/or that revenues will exceed costs is eligible to receive a traditional certificate of public convenience and necessity.

An applicant unable to show the required level of commitment may still receive a certificate but it will be subject to a condition putting the applicant "at risk." In other words, if the project revenues fail to recover the costs, the pipeline rather than its customers will be responsible for the unrecovered costs. Alternatively, a project sponsor can apply for a certificate under Subpart E of Part 157 of the Commission's regulations for an optional certificate. n7 An optional certificate may be granted to an applicant without any market showing at all; however, in practice optional certificate applicants usually make some form of market [\*\*32] showing. The rates for service provided through facilities constructed pursuant to an optional certificate must be designed to impose the economic risk of the project entirely on the applicant.

n7 18 C.F.R. Part 157, Subpart E.

The Commission also has certificated projects that would serve no new market, but would provide some



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demonstrated system-benefit. Examples include projects intended to provide improved system reliability, access to new supplies, or more economic operations.

Generally, under the current policy, the Commission does not deny an application because of the possible economic impact of a proposed project on existing pipelines serving [\*61,744] the same market or on the existing pipelines' customers. In addition, the Commission gives equal weight to contracts between an applicant and its affiliates and an applicant and unrelated third parties and does not look behind the contracts to determine whether the customer commitments represent genuine growth in market demand. n8

n8 See, e.g., Transcontinental Gas Pipe Line Corp., 82 FERC P61,084 at p. 61,316 (1998).

[\*\*33]

Under section 7(h) of the NGA, a pipeline with a Commission-issued certificate has the right to exercise eminent domain to acquire the land necessary to construct and operate its proposed new pipeline when it cannot reach a voluntary agreement with the landowner. n9 In recent years, this has resulted in landowners becoming increasingly active before the Commission. Landowners and communities often object both to the taking of land and to the reduction of their land's value due to a pipeline's right-of-way running through the property. As part of its environmental review of pipeline projects, the Commission's environmental staff works to take these landowners' concerns into account, and to mitigate adverse impacts where possible and feasible.

n9 15 U.S.C. § 717f(h).

Under the pricing policy for new facilities in Docket No. PL94-4-000, n10 the Commission determines, in the certificate proceeding authorizing the facilities' construction, the appropriate pricing for the facilities. Generally, [\*\*34] the Commission applies a presumption in favor of rolled-in rates (rolling-in the expansion costs with the existing facilities' costs) when the cost impact of the new facilities would result in a rate impact on existing customers of five percent or less, and some system benefits would occur. Existing customers generally bear these rate increases without being allowed to adjust their volumes.

n10 See Pricing Policy for New and Existing Facilities Constructed by Interstate Natural Gas Pipelines, 71 FERC P61,241 (1995).

When a pipeline proposes to charge a cost-based incremental rate (establishing separate costs-of-service and separate rates for the existing and expansion facilities) higher than its existing generally applicable rates, the Commission usually approves the proposal. However, the Commission generally will not accept a proposed incremental rate that is lower than the pipeline's existing generally applicable Part 284 rate.

## B. Drawbacks of the Current Policy

### 1. Reliance on Contracts [\*\*35] to Demonstrate Demand

Currently, the Commission uses the percentage of capacity under long-term contracts as the only measure of the demand for a proposed project. Many of the commenters have argued that this is too narrow a test. The reliance solely on long-term contracts to demonstrate demand does not test for all the public benefits that can be achieved by a proposed project. The public benefits may include such factors as the environmental advantages of gas over other fuels, lower fuel costs, access to new supply sources or the connection of new supply to the interstate grid, the elimination of pipeline facility constraints, better service from access to competitive transportation options, and the need for an adequate pipeline infrastructure. The amount of capacity under contract is not a good indicator of all these benefits.

The amount of capacity under contract also is not a sufficient indicator by itself of the need for a project, because the industry has been moving to a practice of relying on short-term contracts, and pipeline capacity is often managed by an entity that is not the actual purchaser of the gas. Using contracts as the primary indicator of market support for [\*\*36] the proposed pipeline project also raises additional issues when the contracts are held by pipeline affiliates. Thus, the test relying on the percent of capacity contracted does not reflect the reality of the natural gas industry's structure and presents difficult issues.

In addition, the current policy's preference for contracts with 10-year terms biases customer choices toward longer term contracts. Of course, there are other elements of the Commission's policies that also have this effect. However, eliminating a specific requirement for a contract of a particular length is more consistent with the Commission's regulatory objective to provide appropriate incentives for efficient customer choices and the optimal level of construction, without biasing those choices through regulatory policies.

Finally, by relying almost exclusively on contract standards to establish the market need for a new project, the current policy makes it difficult to articulate to landowners and community interests why their land must be used for a new pipeline project.

All of these concerns raise difficult questions of establishing the public need for the project.

## 2. The Pricing of New Facilities

As the [\*\*37] industry becomes more competitive the Commission needs to adapt its policies to ensure that they provide the correct regulatory incentives to achieve the Commission's policy goals and objectives. All of the Commission's natural gas policy goals and objectives are affected by its pricing policy, but directly affected [\*\*61,745] are the goals of fostering competitive markets, protecting captive customers, and providing incentives for the optimal level of construction and efficient customer choice. The current pricing policy focuses primarily on the interests of the expanding pipeline and its existing and new shippers, giving little weight to the interests of competing pipelines or their captive customers. As a result, it no longer fits well with an industry that is increasingly characterized by competition between pipelines.

The current pricing policy sends the wrong price signals, as some commenters have argued, by masking the real cost of the expansions. This can result in overbuilding of capacity and subsidization of an incumbent pipeline in its competition with potential new entrants for expanding markets. The pricing policy's bias for rolled-in pricing also is inconsistent with a policy that [\*\*38] encourages competition while seeking to provide incentives for the optimal level of construction and customer choice. This is because rolled-in pricing often results in projects that are subsidized by existing ratepayers. Under this policy the true costs of the project are not seen by the market or the new customers, leading to inefficient investment and contracting decisions. This in turn can exacerbate adverse environmental impacts, distort competition between pipelines for new customers, and financially penalize existing customers of expanding pipelines and of pipelines affected by the expansion.

Under existing policy, shippers' rates may change for a number of reasons. These include rolling-in of an expansion's costs, changes in the discounts given other customers, or changes in the contract quantities flowing on the system. As a customer's rates change in a rate case, it is generally unable to change its volumes, even though it may be paying more for capacity. This results in shippers bearing substantial risks of rate changes which they may be ill equipped to bear.

## III. The New Policy

### A. Summary of the Policy

As a result of the Commission's reassessment of its current policy, [\*\*39] the Commission has decided to announce the criteria, set forth below, that it will use in deciding whether to authorize the construction of major new pipeline facilities. This section summarizes the analytical steps the Commission will use under this policy to balance the public benefits against the potential adverse consequences of an application for new pipeline construction. Each of these steps is described in greater detail in the later sections of this policy statement.

Once a certificate application is filed, the threshold question applicable to existing pipelines is whether the project can proceed without subsidies from their existing customers. As discussed below, this will usually mean that the project would be incrementally priced, if but by an existing pipeline, but there are cases where rolled in pricing would prevent subsidization of the project by the existing customers. If the project cannot be built without subsidies, the Commission will deny the application. n11

n11 This policy does not apply to construction authorized under 18 C.F.R. Part 157, Subparts E and F.

The next step is to determine [\*\*40] whether the applicant has made efforts to eliminate or minimize any adverse



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effects the project might have on the existing customers of the pipeline proposing the project, existing pipelines in the market and their captive customers, or landowners and communities affected by the route of the new pipeline. These three interests are discussed in more detail below. This is not intended to be a decisional step in the process for the Commission. Rather, this is a point where the Commission will review the efforts made by the applicant and could assist the applicant in finding ways to mitigate the effects, but the choice of how to structure the project at this stage is left to the applicant's discretion.

If the proposed project will not have any adverse effect on the existing customers of the expanding pipeline, existing pipelines in the market and their captive customers, or the economic interests of landowners and communities affected by the route of the new pipeline, then no balancing of benefits against adverse effects would be necessary. The Commission would proceed, as it does under current practice, to a preliminary determination or a final order depending on the time required to [\*\*41] complete an environmental assessment (EA) or environmental impact statement (EIS)(whichever is required in the case).

If residual adverse effects on the three interests are identified, after efforts have been made to minimize them, then the Commission will proceed to evaluate the project by balancing the evidence of public benefits to be achieved against the residual adverse effects. This is essentially an economic test. Only when the benefits outweigh the adverse effects on economic interests will the Commission then proceed to complete the environmental analysis where other interests are considered. It is possible at this stage for the Commission to identify conditions that it could impose on the certificate that would further minimize or eliminate adverse impacts and take those into [\*\*61,746] account in balancing the benefits against the adverse effects. If the result of the balancing is a conclusion that the public benefits outweigh the adverse effects then the next steps would be the same as for a project that had no adverse effects. That is, if the EA or EIS would take more than approximately 180 days then a preliminary determination could be issued, followed by the EA or EIS and the [\*\*42] final order. If the EA would take less time, then it would be combined with the final order.

#### B. The Threshold Requirement - No Financial Subsidies

The threshold requirement in establishing the public convenience and necessity for existing pipelines proposing an expansion project is that the pipeline must be prepared to financially support the project without relying on subsidization from its existing customers. n12 This does not mean that the project sponsor has to bear all the financial risk of the project; the risk can be shared with the new customers in preconstruction contracts, but it cannot be shifted to existing customers. For new pipeline companies, without existing customers, this requirement will have no application.

n12 Projects designed to improve existing service for existing customers, by replacing existing capacity, improving reliability or providing flexibility, are for the benefit of existing customers. Increasing the rates of the existing customers to pay for these improvements is not a subsidy. Under current policy these kinds of projects are permitted to be rolled in and are not covered by the presumption of the current pricing policy. Great Lakes Gas Transmission Limited Partnership, 80 FERC P61,105 (1997) (Pricing policy statement not applicable to facilities constructed solely for flexibility and system reliability).

[\*\*43]

The requirement that the project be able to stand on its own financially without subsidies changes the current pricing policy which has a presumption in favor of rolled-in pricing. Eliminating the subsidization usually inherent in rolled-in rates recognizes that a policy of incrementally pricing facilities sends the proper price signals to the market. With a policy of incremental pricing, the market will then decide whether a project is financially viable. The commenters were divided on whether the Commission should change its current pricing policy. A number of commenters, however, urged the Commission to allow the market to decide which projects should be built, and this requirement is a way of accomplishing that result.

The requirement helps to address all of the interests that could be adversely affected. Existing customers of the expanding pipeline should not have to subsidize a project that does not serve them. Landowners should not be subject to eminent domain for projects that are not financially viable and therefore may not be viable in the marketplace. Existing pipelines should not have to compete against new entrants into their markets whose projects receive a financial [\*\*44] subsidy (via rolled-in rates), and neither pipeline's captive customers should have to shoulder the costs of unused capacity that results from competing projects that are not financially viable. This is the only condition that

uniformly serves to avoid adverse effects on all of the relevant interests and therefore should be a test for all proposed expansion projects by existing pipelines. It will be the predicate for the rest of the evaluation of a new project by an existing pipeline.

A requirement that the new project must be financially viable without subsidies does not eliminate the possibility that in some instances the project costs should be rolled into the rates of existing customers. In most instances incremental pricing will avoid subsidies for the new project, but the situation may be different in cases of inexpensive expansibility that is made possible because of earlier, costly construction. In that instance, because the existing customers bear the cost of the earlier, more costly construction in their rates, incremental pricing could result in the new customers receiving a subsidy from the existing customers because the new customers would not face the full cost of the [\*\*45] construction that makes their new service possible. The issue of the rate treatment for such cheap expansibility is one that always should be resolved in advance, before the construction of the pipeline.

Another instance where a form of rolling in would be appropriate is where a pipeline has vintages of capacity and thus charges shippers different prices for the same service under incremental pricing, and some customers have the right of first refusal (ROFR) to renew their expiring contracts. Those customers could be allowed to exercise a ROFR at their original contract rate except when the incremental capacity is fully subscribed and there are competing bids for the existing customer's capacity. In that case, the existing customer could be required to match the highest competing bid up to a maximum rate which could be either an incremental rate or a "rolled-up rate" in which costs for expansions are accumulated to yield an average expansion rate. Although the focus of this policy statement is the analysis for deciding whether new capacity should be constructed, it is important for the Commission to articulate the direction of its policy on pricing existing capacity where a pipeline [\*\*46] has engaged in expansions. This will enable existing and potential new shippers to make appropriate decisions pre-construction to protect their interests [\*\*61,747] either in the certificate proceeding or in their contracts with the pipeline.

This policy leaves the pipeline responsible for the costs of new capacity that is not fully utilized and obviates the need for an "at risk" condition because it accomplishes the same purpose. Under this policy the pipeline bears the risk for any new capacity that is under-utilized, unless, as recommended by a number of commenters, it contracts with the new customers to share that risk by specifying what will happen to rates and volumes under specific circumstances. If the pipeline finds that new shippers are unwilling to share this risk, this may indicate to the pipeline that others do not share its vision of future demand. Similarly, the risks of construction cost over-runs should not be the responsibility of the pipeline's existing customers but should be apportioned between the pipeline and the new customers in their service contracts. Thus, in pipeline contracts for service on newly constructed facilities, pipelines should not rely on standard "Memphis [\*\*47] clauses", but should reach agreement with new shippers concerning who will bear the risks of underutilization of capacity and cost overruns and the rate treatment for "cheap expansibility." n13

n13 "Memphis clause" refers to an agreement that the pipeline may change the rate during the term of the contract by making rate filings under NGA section 4.

In sum, if an applicant can show that the project is financially viable without subsidies, then it will have established the first indicator of public benefit. Companies willing to invest in a project, without financial subsidies, will have shown an important indicator of market-based need for a project. Incremental pricing will also lead to the correct price signals for the new project and provide the appropriate incentive for the optimal level of construction. This can avoid unnecessary adverse impacts on landowners or existing pipelines and their captive customers. Therefore, this will be the threshold requirement for establishing that a project will satisfy the public [\*\*48] convenience and necessity standard.

### C. Factors to be Balanced in Assessing the Public Convenience and Necessity

Ideally, an applicant will structure its proposed project to avoid adverse economic, competitive, environmental, or other effects on the relevant interests from the construction of the new project, and the Commission would be able to approve such projects promptly. Of course, elimination of all adverse effects will not be possible in every instance. When it is not possible, the Commission's policy objective is to encourage the applicant to minimize the adverse impact on each of the relevant interests. After the applicant makes efforts to minimize the adverse effects, construction projects that would have residual adverse effects would be approved only where the public benefits to be achieved from the project can be found to outweigh the adverse effects. Rather than relying only on one test for need, the



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Commission will consider all relevant factors reflecting on the need for the project. These might include, but would not be limited to, precedent agreements, demand projections, potential cost savings to consumers, or a comparison of projected demand with the amount of capacity [\*\*49] currently serving the market. The objective would be for the applicant to make a sufficient showing of the public benefits of its proposed project to outweigh any residual adverse effects discussed below.

### 1. Consideration of Adverse Effects on Potentially Affected Interests

In deciding whether a proposal is required by the public convenience and necessity, the Commission will consider the effects of the project on all the affected interests; this means more than the interests of the applicant, the potential new customers, and the general societal interests.

Depending on the type of project, there are three major interests that may be adversely affected by approval of major certificate projects, and that must be considered by the Commission. These are: the interests of the applicant's existing customers, the interests of competing existing pipelines and their captive customers, and the interests of landowners and surrounding communities. There are other interests that may need to be separately considered in a certificate proceeding, such as environmental interests.

Of course, not every project will have an impact on each interest identified. Some projects will be proposed by new pipeline [\*\*50] companies to serve new markets, so that there will be no adverse effects on the interests of existing customers; other projects may be constructed so that there may be no adverse effect on landowner interests.

#### a. Interests of existing customers of the pipeline applicant

The interests of the existing customers of the expanding pipeline may be adversely affected if the expansion results in their rates being increased or if the expansion causes a degradation in service.

#### b. Interests of Existing Pipelines that Already Serve the Market and their Captive Customers [\*\*61,748]

Pipelines that already serve the market into which the new capacity would be built are affected by the potential loss of market share and the possibility that they may be left with unsubscribed capacity investment. The Commission need not protect pipeline competitors from the effects of competition, but it does have an obligation to ensure fair competition. Recognizing the impact of a new project on existing pipelines serving the market is not synonymous with protecting incumbent pipelines from the risk of loss of market share to a new entrant, but rather, is a recognition that the impact on the incumbent pipeline is an interest [\*\*51] to be taken into account in deciding whether to certificate a new project. The interests of the existing pipeline's captive customers are slightly different from the interests of the pipeline. The interests of the captive customers of the existing pipelines are affected because, under the Commission's current rate model, they can be asked to pay for the unsubscribed capacity in their rates.

#### c. Interests of landowners and the surrounding communities

Landowners whose land would be condemned for the new pipeline right-of-way, under eminent domain rights conveyed by the Commission's certificate, have an interest as does the community surrounding the right-of-way. The interest of these groups is to avoid unnecessary construction, and any adverse effects on their property associated with a permanent right-of-way. In some cases, the interests of the surrounding community may be represented by state or local agencies. Traditionally, the interests of the landowners and the surrounding community have been considered synonymous with the environmental impacts of a project; however, these interests can be distinct. Landowner property rights issues are different in character from other environmental [\*\*52] issues considered under the National Environmental Policy Act of 1969 (NEPA). n14

n14 42 U.S.C. § 4321 et seq.

### 2. Indicators of Public Benefit

To demonstrate that its proposal is in the public convenience and necessity, an applicant must show public benefits that would be achieved by the project that are proportional to the project's adverse impacts. The objective is for the applicant to create a record that will enable the Commission to find that the benefits to be achieved by the project will outweigh the potential adverse effects, after efforts have been made by the applicant to mitigate these adverse effects. The types of public benefits that might be shown are quite diverse but could include meeting unserved demand,



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eliminating bottlenecks, access to new supplies, lower costs to consumers, providing new interconnects that improve the interstate grid, providing competitive alternatives, increasing electric reliability, or advancing clean air objectives. Any relevant evidence could [\*\*53] be presented to support any public benefit the applicant may identify. This is a change from the current policy which relies primarily on one test to establish the need for the project.

The amount of evidence necessary to establish the need for a proposed project will depend on the potential adverse effects of the proposed project on the relevant interests. Thus, projects to serve new demand might be approved on a lesser showing of need and public benefits than those to serve markets already served by another pipeline. However, the evidence necessary to establish the need for the project will usually include a market study. There is no reason for an applicant to do a new market study of its own in every instance. An applicant could rely on generally available studies by EIA or GRI, for example, showing projections of market growth. If one of the benefits of a proposed project would be to lower gas or electric rates for consumers, then the applicant's market study would need to explain the basis for that projection. Vague assertions of public benefits will not be sufficient.

Although the Commission traditionally has required an applicant to present contracts to demonstrate need, that [\*\*54] policy, as discussed above, no longer reflects the reality of the natural gas industry's structure, nor does it appear to minimize the adverse impacts on any of the relevant interests. Therefore, although contracts or precedent agreements always will be important evidence of demand for a project, the Commission will no longer require an applicant to present contracts for any specific percentage of the new capacity. Of course, if an applicant has entered into contracts or precedent agreements for the capacity, it will be expected to file the agreements in support of the project, and they would constitute significant evidence of demand for the project.

Eliminating a specific contract requirement reduces the significance of whether the contracts are with affiliated or unaffiliated shippers, which was the subject of a number of comments. A project that has precedent agreements with multiple new customers may present a greater indication of need than a project with only a precedent agreement with an affiliate. The new focus, however, will be on the impact of the project on the relevant interests balanced against the benefits to be gained from the project. As long as the project is built [\*\*55] without subsidies from the existing ratepayers, [61,749] the fact that it would be used by affiliated shippers is unlikely to create a rate impact on existing ratepayers. With respect to the impact on the other relevant interests, a project built on speculation (whether or not it will be used by affiliated shippers) will usually require more justification than a project built for a specific new market when balanced against the impact on the affected interests.

### 3. Assessing Public Benefits and Adverse Effects

The more interests adversely affected or the more adverse impact a project would have on a particular interest, the greater the showing of public benefits from the project required to balance the adverse impact. The objective is for the applicant to develop whatever record is necessary, and for the Commission to impose whatever conditions are necessary, for the Commission to be able to find that the benefits to the public from the project outweigh the adverse impact on the relevant interests.

It is difficult to construct helpful bright line standards or tests for this area. Bright line tests are unlikely to be flexible enough to resolve specific cases and to allow the Commission to take [\*\*56] into account the different interests that must be considered. Indeed, the current contract test has become problematic. However, the analytical framework described here should give applicants more certainty and sufficient guidance to anticipate how to structure their projects and develop the record to facilitate the Commission's decisional process.

Under this policy, if project sponsors, proposing a new pipeline company, are able to acquire all, or substantially all, of the necessary right-of-way by negotiation prior to filing the application, and the proposal is to serve a new, previously unserved market, it would not adversely affect any of the three interests. Such a project would not need any additional indicators of need and may be readily approved if there are no environmental considerations. Under these circumstances landowners would not be subject to eminent domain proceedings, and because the pipeline was new, there would be no existing customers who might be called upon to subsidize the project. A similar result might be achieved by an existing pipeline extending into a new unserved market by negotiating for a right-of-way for the proposed expansion and following the first [\*\*57] requirement for showing need, financing the project without financial subsidies. It would avoid adverse impacts to existing customers by pricing its new capacity incrementally and it is unlikely that other relevant interests would be adversely affected if the pipeline obtained the right-of-way by negotiation.



It may not be possible to acquire all the necessary right-of-way by negotiation. However, the company might minimize the effect of the project on landowners by acquiring as much right-of-way as possible. In that case, the applicant may be called upon to present some evidence of market demand, but under this sliding scale approach the benefits needed to be shown would be less than in a case where no land rights had been previously acquired by negotiation. For example, if an applicant had precedent agreements with multiple parties for most of the new capacity, that would be strong evidence of market demand and potential public benefits that could outweigh the inability to negotiate right-of-way agreements with some landowners. Similarly, a project to attach major new gas supplies to the interstate grid would have benefits that may outweigh the lack of some right-of-way agreements. [\*\*58] A showing of significant public benefit would outweigh the modest use of federal eminent domain authority in this example.

In most cases it will not be possible to acquire all the necessary right-of-way by negotiation. Under this policy, a few holdout landowners cannot veto a project, as feared by some commenters, if the applicant provides support for the benefits of its proposal that justifies the issuance of a certificate and the exercise of the corresponding eminent domain rights. The strength of the benefit showing will need to be proportional to the applicant's proposed exercise of eminent domain procedures.

Of course, the Commission will continue to do an independent environmental review of projects, even if the project does not rely on the use of eminent domain and the applicant structures the project to avoid or minimize adverse impacts on any of the identified interests. The Commission anticipates no change to this aspect of its certificate policies. However, to the extent applicants minimize the adverse impacts of projects in advance, this should also lessen the adverse environmental impacts as well, making the NEPA analysis easier. The balancing of interests and benefits [\*\*59] that will precede the environmental analysis will largely focus on economic interests such as the property rights of landowners. The other interests of landowners and the surrounding community, such as noise reduction or esthetic concerns will continue to be taken into account in the environmental analysis. If the environmental analysis following a preliminary determination indicates a preferred route other than the one proposed by the applicant, the earlier balancing of the public benefits of the project against its adverse effects would be reopened to take into account the adverse effects on landowners who would be affected by the changed route. [\*61,750]

In another example of the proportional approach, a proposal that may have adverse impacts on customers of another pipeline may require evidence of additional benefits to consumers, such as lower rates for the customers to be served. The Commission might also consider how the proposal would affect the cost recovery of the existing pipeline, particularly the amount of unsubscribed capacity that would be created and who would bear that risk, before approving the project. This evaluation would be needed to ensure consideration of the interests [\*\*60] of the existing pipeline and particularly its captive customers. Such consideration does not mean that the Commission would always favor existing pipelines and their captive customers. For instance, a proposed project may be so efficient and offer substantial benefits, such as significant service flexibility, so that the benefits would outweigh the adverse impact on existing pipelines and their captive customers.

A number of commenters were concerned that the Commission might give too much weight to the impact on the existing pipeline and its captive customers and undervalue the benefits that can arise from competitive alternatives. The Commission's focus is not to protect incumbent pipelines from the risk of loss of market share to a new entrant, but rather to take the impact into account in balancing the interests. In such a case the evidence of benefits will need to be more specific and detailed than the generalized benefits that arise from the availability of competitive alternatives. The interests of the captive customers are slightly different from the interests of the incumbent pipeline. The captive customers are affected if the incumbent pipeline shifts to the captive customers [\*\*61] the costs associated with its unsubscribed capacity. Under the Commission's current rate model captive customers can be asked to pay for unsubscribed capacity in their rates, but the Commission has indicated that it will not permit all costs resulting from the loss of market share to be shifted to captive customers. n15 Whether and to what extent costs can be shifted is an issue to be resolved in the incumbent pipeline's rate case, but the potential impact on these captive customers is a factor to be taken into account in the certificate proceeding of the new entrant.

n15 El Paso Natural Gas Company, 72 FERC P61,083 (1995); Natural Gas Pipeline Company of America, 73 FERC P61,050 (1995).

In sum, the Commission will approve an application for a certificate only if the public benefits from the project



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outweigh any adverse effects. Under this policy, pipelines seeking a certificate of public convenience and necessity authorizing the construction of facilities are encouraged [\*\*62] to submit applications designed to avoid or minimize adverse effects on relevant interests including effects on existing customers of the applicant, existing pipelines serving the market and their captive customers, and affected landowners and communities. The threshold requirement for approval, that project sponsors must be prepared to develop the project without relying on subsidization by the sponsor's existing customers, protects all of the relevant interests. Applicants also must submit evidence of the public benefits to be achieved by the proposed project such as contracts, precedent agreements, studies of projected demand in the market to be served, or other evidence of public benefit of the project.

#### V. Conclusion

At a time when the Commission is urged to authorize new pipeline capacity to meet an anticipated increase in the demand for natural gas, the Commission is also urged to act with caution to avoid unnecessary rights-of-way and the potential for overbuilding with the consequent effects on existing pipelines and their captive customers. This policy statement is intended to provide more certainty as to how the Commission will analyze certificate applications to balance [\*\*63] these concerns. By encouraging applicants to devote more effort in advance of filing to minimize the adverse effects of a project, the policy gives them the ability to expedite the decisional process by working out contentious issues in advance. Thus, this policy will provide more guidance about the Commission's analytical process and provide participants in certificate proceedings with a framework for shaping the record that is needed by the Commission to expedite its decisional process.

Finally, this new policy will not be applied retroactively. A major purpose of the policy statement is to provide certainty about the decisionmaking process and the impacts that would result from approval of the project. This includes providing participants in a certificate proceeding certainty as to economic impacts that will result from the certificate. It is important for the participants to know the economic consequences that can result before construction begins. After the economic decisions have been made it is difficult to undo those choices. Therefore, the new policy will not be applied retroactively to cases where the certificate has already issued and the investment decisions have been [\*\*64] made. [\*61,751]

By the Commission. Chairman Hoecker and Commissioners Breathitt and Hebert concurred with a separate statement attached.

Commissioner Bailey dissented with a separate statement attached.

**CONCURBY: HOECKER, BREATHITT AND HEBERT**

**CONCUR:**

James J. HOECKER, Chairman; Linda K. BREATHITT and Curt HEBERT, Jr., Commissioners, concurring;

Our intention is to apply this policy statement to any filings received by the Commission after July 29, 1998 (the issuance date of the Commission's Notice of Proposed Rulemaking regarding the Regulation of Short-term Natural Gas Transportation Services in Docket No. RM98-10-000 and Notice of Inquiry regarding Regulation of Interstate Natural Gas Transportation Services in Docket No. RM98-12-000), and not before.

James J. Hoecker

Chairman

Linda K. Breathitt

Commissioner

Curt L. Hebert

Commissioner

**DISSENTBY: BAILEY**

**DISSENT:**

Vicky A. BAILEY, Commissioner, dissenting.

Respectfully, I will be dissenting from this policy statement.

The document puts forth the majority's statement of an analytical framework for use in certificate proceedings. Its goal is to give applicants and other participants in those proceedings a better understanding of how the Commission makes its decisions. This is always a good thing [\*\*65] to do. But ultimately, I cannot sign on to this statement as representative of my approach to certificate policy for several reasons.

First and foremost, the document purports that the policy outlined is not a significant departure from the kind of analysis used currently in certificate cases. I do not share this view. I know that it does depart from the way I currently look at certificate issues. For example, I cannot say that the sliding scale evaluation process and the weighing and balancing process described in the statement actually reflects the way I look at things. Further, the pricing changes announced are in fact significant departures from current practice. Thus, the document is as much about pricing policy change as it is about articulating an analytical approach to certification questions. I do not completely agree with the statements regarding pricing contained in this document.

The announced policy will now require that new projects meet a pricing threshold before work can proceed on the application - that is they should be incrementally priced and not subsidized by existing customers. The intent behind this is to enhance our certainty that the market is determining [\*\*66] which projects come to the Commission.

I do not disagree with the idea that incremental pricing is consistent with the idea of allowing markets to decide. I also recognize that it can protect existing customers from subsidizing expansions as well as insulate existing pipelines from subsidized competition. However, I find the policy statement to be far too categorical in its approach. I am not persuaded that we should depart from our existing policy statement on pricing that we adopted in 1995.

There is too little recognition here that some types of construction projects are not designed solely for new markets or customers, that existing customers can benefit from some projects, and that rolled-in pricing may still be appropriate. Thus, while I can agree with some of the articulated goals such as pricing should allocate risk appropriately, and that if done properly it can assist in avoiding construction of excess capacity, I would not adopt a threshold requirement that virtually precludes use of rolled-in rates.

Finally, I am at a loss to explain the genesis of this particular outcome. I recognize that certificate policy issues have been problematic for a long time. In attempts to address [\*\*67] these issues we have had conferences to explore need issues and we have requested comments on certificate issues in the pending gas Notice of Proposed Rulemaking in Docket No. RM98-10-000 (84 FERC P61,087 (1998)) and the Notice of Inquiry in Docket No. RM98-12-000 (84 FERC P61,087 (1998)). The variety of views we have received in these efforts are summarized in the policy statement and it candidly recognizes the lack of clear direction on what path the Commission should follow. Given this lack of industry consensus, I question the advisability of trying to adopt a generic approach at this time. I would prefer to weigh further the relative merits of those comments before embarking on an attempt to articulate a certificate policy.

Vicky A. Bailey

Commissioner