

October 21, 2010

## FERC Requests Comments on Capacity Assignment Rules for Interstate Service Offered by Section 311 and Hinshaw Pipelines

Today the Federal Energy Regulatory Commission (FERC or Commission) issued a Notice of Inquiry (NOI) ([attached](#)) requesting comments regarding whether and how holders of firm interstate capacity on section 311 and Hinshaw pipelines can allow others to use their capacity, including to what extent buy/sell transactions should be permitted. Comments will be due 60 days from the date of publication in the Federal Register.

### Enforcement of Buy/Sell Prohibition on Section 311 and Hinshaw Pipelines Pending Resolution

In light of the uncertainty continuing to surround these issues, the Commission has decided that it "will not institute any enforcement actions with respect to prior buy/sell transactions involving section 311 and Hinshaw pipelines." The Commission also grants "a blanket waiver of the prohibition on buy/sell transactions to allow existing and new buy/sell transactions involving section 311 and Hinshaw pipelines to continue to take place until the Commission issues a further order in this proceeding."

### Background

Section 311 of the Natural Gas Policy Act (NGPA) allows intrastate pipelines to offer interstate natural gas transportation (and storage) services without subjecting themselves to the full panoply of FERC regulations applicable to interstate pipelines under the Natural Gas Act (NGA). Pipelines that take advantage of this opportunity often are referred to as "311 pipelines." FERC also permits Hinshaw pipelines to provide jurisdictional service under terms similar to those provided by 311 pipelines without jeopardizing their exempt status under the NGA. Hinshaw pipelines are pipelines that receive gas from interstate commerce but operate wholly within one state, whose rates and services are subject to regulation by that state, and whose gas is wholly consumed within the state. Historically and currently, 311 pipelines and Hinshaw pipelines have not been required to implement capacity release programs to facilitate the assignment of capacity in an open and transparent market.

The NOI issued today stems from industry response to an order issued by the Commission on July 23, 2010, denying a request for clarification submitted by Arizona Public Service Company and Sequent Energy Management for confirmation that the buy sell prohibition does not apply to interstate services offered by Hinshaw pipelines pursuant to Section 284.224 of the Commission's regulations. In its order, FERC refused to grant a blanket authorization for the use of a buy sell arrangement by shippers using interstate services on Hinshaw pipelines, or on intrastate pipelines offering interstate services pursuant to section 311 of the NGPA. The Commission instead granted the parties a limited waiver and offered to grant case-specific waivers where good cause exists. In response, multiple parties sought rehearing of the decision, most arguing that FERC's shipper-must-have-title requirement and buy sell prohibition should not apply to section 311 and Hinshaw pipelines offering interstate service. One party argued that FERC should require such pipelines to offer capacity release pursuant to FERC's capacity release rules. Today, the Commission issued an order dismissing the requests for rehearing ([attached](#)).

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## Questions Related to Application of Buy/Sell Prohibition to Section 311 and Hinshaw Pipelines

1. Are buy/sell transactions commonly used in connection with service on section 311 and Hinshaw pipelines or are such transactions relatively rare? Are such transactions more commonly used with respect to storage capacity as in *APS/Sequent* or are they used with respect to all types of services? Have such transactions provided for more efficient use of firm capacity on section 311 and Hinshaw pipelines?
2. Are there any experiences or concerns of undue discrimination or preference or loss of market transparency related to the buy/sell transactions which have occurred on section 311 and Hinshaw pipelines?
3. Could buy/sell transactions be allowed without risk of undue discrimination or preference or loss of market transparency? Section 311 and Hinshaw pipelines generally include in their statements of operating conditions a requirement that shippers possess title to the gas being stored or transported. Is application of the shipper-must-have-title rule sufficient to minimize concerns about undue discrimination and transparency, since it ensures that the capacity holder has an interest in the gas being transported?
4. When the Commission grandfathered existing buy/sell transactions at the time of Order No. 636, the Commission required participants in those transactions to notify the interstate pipeline of them, and the Commission required the pipeline, for informational purposes, to post notice of the transactions on its electronic bulletin board. Would a similar reporting requirement for participants in buy/sell transactions to notify the relevant section 311 and Hinshaw pipelines and for those pipelines to post notice of them reasonably mitigate concerns related to undue discrimination or preference or loss of market transparency?
5. In *ANR*, the U.S. Court of Appeals for the District of Columbia Circuit held that the Commission must provide a reasonable justification for excluding section 311 pipelines from requirements imposed on interstate pipelines, where such regulatory differences may place the interstate pipelines at a competitive disadvantage. Would allowing buy/sell transactions on section 311 and Hinshaw pipelines, but not on interstate natural gas pipelines, cause any competitive disadvantage to interstate pipelines?
6. Consistent with the NGPA's goal of encouraging intrastate pipelines to provide interstate service, the Commission has not imposed on intrastate pipelines all of the Part 284 requirements imposed on interstate pipelines. Would extending the buy/sell prohibition to service on section 311 and Hinshaw pipelines deter intrastate pipelines from participating in the interstate market? If so, explain what burdens such a prohibition places on section 311 and Hinshaw pipelines that would make them less likely to offer interstate service.

## Questions Regarding Requiring Capacity Release for Firm Services

1. Should the Commission reexamine its decision not to require section 311 and Hinshaw pipelines to offer capacity release in light of market changes since the issuance of Order No. 636 in 1992 and the success of the interstate capacity release program?
2. As discussed above, the U.S. Court of Appeals for the District of Columbia Circuit has held that the Commission "must provide a reasonable justification for excluding" an intrastate pipeline from a requirement that binds interstate pipelines. Similarly, the Commission has held that it may grant intrastate facilities "additional flexibility," but not if lighter regulation would "harm any party [or] impede the Commission's goal of fostering a national pipeline grid." Does the absence of a transparent method for shippers on section 311 and Hinshaw pipelines to reassign their capacity interfere with the Commission's goal of fostering an efficient national pipeline grid in which buyers

and sellers of natural gas have the maximum ability to reach one another? Would requiring some or all section 311 and Hinshaw pipelines to offer capacity release provide sufficient benefits to the market as a whole to outweigh any costs incurred as a result of such a requirement? Does exempting section 311 and Hinshaw pipelines from offering capacity release give them a competitive advantage over interstate pipelines?

3. Should any requirement for section 311 and Hinshaw pipelines to offer capacity release be limited to some category of such pipelines whose services significantly affect interstate markets? If so, how should that category be defined (e.g., based on size as shown by annual throughput above a certain level, percentage of business that is interstate, or storage providers with market-based rates)?
4. In Order No. 720, the Commission required major non-interstate pipelines, defined as those pipelines that are not natural gas companies under the NGA and deliver annually more than 50 million MMBtu measured in average deliveries over the past three years, to post daily scheduled volume information. Should the Commission adopt the threshold utilized in Order No. 720 to determine which section 311 and Hinshaw pipelines would be required to offer capacity release?
5. Should any requirement to offer capacity release be limited to section 311 and Hinshaw pipelines whose business is predominantly interstate? If so, what standard should be used to determine if such a pipeline's business is predominantly interstate?
6. Would a requirement that section 311 and Hinshaw pipelines offering firm service also offer capacity release discourage such pipelines from offering any firm interstate service? Would this concern be minimized if the requirement to offer capacity release is limited to larger section 311 and Hinshaw pipelines whose services are predominantly interstate?
7. If section 311 and Hinshaw pipelines are required to offer capacity release, should the regulations be the same as the capacity release regulations for interstate pipelines set forth in section 284.8 of the Commission's regulations? Would a subset of those regulations be sufficient for purposes of preventing undue discrimination and promoting transparency, while minimizing any burden on the pipelines offering capacity release?



*If you have any questions about this Legal Alert, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.*

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