

D.C. Circuit Vacates FERC Order No. 2004's Standards of Conduct as Applied to Natural Gas Pipelines

November 20, 2006

On November 17, the D.C. Circuit issued a decision in *National Fuel Gas Supply Corporation v. FERC* which vacates the Federal Energy Regulatory Commission's (FERC) standards of conduct promulgated by Order Nos. 2004, et al. (Order No. 2004) as applied to natural gas pipelines, and remands the issues to FERC for further consideration. The court's decision did not affect the applicability of Order No. 2004 to electric utilities.

Background

FERC's standards of conduct are intended to prevent natural gas pipelines and electric utilities from providing preferential access to service or information to affiliated entities. In Order No. 2004, FERC combined its previously distinct standards of conduct for natural gas pipelines (promulgated under Order No. 497) and electric utilities (promulgated under Order No. 889), which it collectively defined as "transmission providers." In addition, Order No. 2004 extended the standards of conduct to govern transmission providers' relationships with their "energy affiliates." For natural gas pipelines, this change extended regulation beyond relationships with marketing affiliates to cover relationships with affiliated gas processors, gatherers, producers, and local distribution companies. Several gas industry entities, including the Interstate Natural Gas Association of America, petitioned the D.C. Circuit for review of Order No. 2004, challenging FERC's extension of the standards of conduct to non-marketing affiliates of natural gas pipelines.

D.C. Circuit Decision

Petitioners contended that the record lacked any evidence of actual preference provided non-marketing affiliates that would justify expanding coverage of the standards of conduct to non-marketing affiliates. The D.C. Circuit agreed, drawing upon its 1992 decision in *Tenneco Gas v. FERC*, which upheld Order 497's adoption of standards of conduct governing natural gas pipelines and their marketing affiliates because FERC's record showed: 1) a plausible theoretical threat of anti-competitive information-sharing between pipelines and their marketing affiliates; and 2) a "vast" record of abuse between pipelines and their marketing affiliates. In issuing and defending Order No. 2004, FERC similarly relied on both a theoretical threat and a record of abuse between pipelines and their non-marketing affiliates. The court, however, found that unlike Order No. 497, Order No. 2004 cited "no complaints and provided zero evidence of actual abuse between pipelines and their non-marketing affiliates." The court also noted that Commissioners Kelliher and Brownell had dissented from Order No. 2004 orders on these grounds.

The court provided guidance for FERC to consider on remand. It suggested that FERC may decide not to proceed with rules applicable to pipelines' non-marketing affiliates, or alternatively, that FERC may seek to develop a factual record that could fully satisfy the two-part standard of *Tenneco*. The court also noted several types of analyses FERC would need to undertake to support Order No. 2004 solely on the basis of a theoretical threat of affiliate abuse, although it expressly declined to say whether any of its suggested rationales, alone or in combination, would sufficiently justify application of the standards of conduct to natural gas pipelines' relationships with their non-marketing affiliates. The court stated, for example, that if FERC chooses to rely solely on a theoretical threat, it would need to explain why the complaint procedure under section 5 of the Natural Gas Act does not suffice to ensure that natural gas pipelines are not abusing their relationships with non-marketing affiliates.

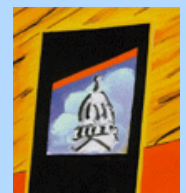
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Implications and Uncertainties

While the court's opinion focuses almost exclusively on the sufficiency of FERC's record to support the rules for non-marketing affiliates, the decision vacates Order No. 2004 in its entirety as applied to natural gas pipelines. The intended effect of the court's vacation of Order No. 2004 with respect to natural gas pipelines is not clear. Order No. 2004 superseded the prior natural gas standards of conduct established by Order No. 497, and removed the related regulatory text from the Code of Federal Regulations. One interpretation of the court's action is that the Order 497 regulations that were removed by Order No. 2004 are reinstated as a result of Order No. 2004's vacation. Another view is that FERC must take action to reinstate Order No. 497 or issue an interim rule pending full proceedings on remand. Parties may seek rehearing or clarification to address this uncertainty.

In most respects, the pre-existing Order No. 497 requirements were narrower than the Order No. 2004 requirements, but Order No. 2004 had provided some useful clarifications on issues such as shared employees that may now be ineffective.

The significance of the court's ruling for electric utilities currently subject to Order No. 2004 is uncertain. The court's decision vacates and remands Order No. 2004 only with respect to natural gas pipelines; no electric utilities petitioned for review of the standards of conduct as applied to them. However, because the very same standards of conduct apply to both natural gas pipelines and electric utilities under Order No. 2004, electric utilities may have the opportunity on remand to weigh in on the same set of issues about coverage of non-marketing affiliates.

Finally, the composition of the Commission that will reconsider these issues on remand is quite different than the Commission that originally approved Order No. 2004. None of the commissioners who sat on the FERC in 2003 when Order No. 2004 was initially approved remain on the Commission. Commissioner Kelliher, who dissented on the rehearing orders based on these issues concerning scope of the rule, now serves as chairman of the FERC.

For Additional Information

Van Ness Feldman actively represented clients in the rulemaking that led to Order No. 2004, and counsels clients on the full range of standards of conduct compliance issues. For additional information on this case, or for assistance in assessing the implications of the decision for your company, please contact Curt Moffatt, Doug Smith or any member of our Natural Gas or Electricity practices at (202) 298-1800.

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