

similar mechanisms to prevent transmission from being used in an undue preferential or discriminatory manner by: (1) Separating employees⁸ engaged in transmission services from those engaged in commodity marketing services, *i.e.*, marketing or sales for resale of natural gas or electric energy; and (2) ensuring that all transmission customers, affiliated and non-affiliated, are treated on a non-discriminatory basis. The Commission's goals have not changed. This rule is designed to prevent Transmission Providers from giving undue preferences to any of their Energy Affiliates to ensure that transmission is provided on a non-discriminatory basis.

III. Need for the Rule

6. As discussed in the NOPR, significant changes have occurred since the standards of conduct were first adopted. In Order No. 636, the Commission required all interstate natural gas pipelines to provide open-access transportation service and to unbundle their gas sales from transportation.⁹ Since then, the market has expanded to include both physical and financial transactions by marketing and non-marketing gas pipeline affiliates.¹⁰ In the gas industry, these changes include unbundling, capacity release, and e-commerce. Today, as a result of growth and consolidations, many interstate natural gas pipeline companies also have a much wider array of affiliates in all sectors of the energy business. The gas industry has

experienced consolidations in every sector—pipelines, producers, marketers, LDC/utilities and industrials. Examples include the mergers of El Paso Energy Corporation, Sonat Inc. and the Coastal Corporation, and Columbia Energy Group and NiSource Inc. Marketing affiliates and non-marketing affiliates today offer a variety of new services, such as bundled sales, asset management, price hedging, risk management, and electronic commodity trading. Recently, some pipelines have reduced or eliminated some of these services, while others continue to have active merchant, management and trading functions.

7. Similarly, now that public utility Transmission Providers have been providing open-access service under Order No. 888 for several years, there has been a large increase in the number of power marketers with market-based rates,¹¹ an increased market for available transmission capacity, and an increased number of power transactions. Electric power is evolving into a more liquid, transparent commodity.

8. Not only are the affiliated entities changing in size and scope, so are the Transmission Providers. As a result of an increase in merger activities there has been a convergence of the gas and electric industries.¹² These industry changes mean that interstate natural gas pipelines and their affiliates not only deal in gas, but also in power, much of which is generated using natural gas. In one of its recent regulatory reviews, the Federal Trade Commission (FTC) found that the proposed acquisition of Panhandle and Trunkline by CMS was likely to adversely affect industrial plants in the CMS local natural gas franchise areas that rely on natural gas as a fuel to generate electric power onsite.¹³

9. The Commission is concerned that a Transmission Provider's market power could be transferred to its affiliated businesses because the existing rules do not cover all affiliate relationships. For

example, an integrated entity could exercise market power in delivered natural gas service to raise costs of rival generators or inhibit entry of new generators into wholesale power markets.

10. Although the current standards of conduct limit Transmission Providers' ability to make or grant undue preferences to their wholesale merchant functions or to their marketing affiliates, they do not cover the transmission providers' other non-marketing affiliates, even though the NGA and FPA prohibit a natural gas pipeline company and a public utility from giving any entity an undue preference. Non-marketing affiliates of Transmission Providers compete against non-affiliates for transmission services, in capacity release transactions, in power sales, and in siting new generation. For example, in the gas industry, non-marketing affiliates of interstate natural gas pipelines control large amounts of capacity on their affiliated pipelines, yet they are not covered by the current standards of conduct because they do not actually hold pipeline capacity (functioning instead as asset managers) or they fit within one of the existing exceptions, *e.g.*, producers, gatherers and local distribution companies.¹⁴ See 18 CFR 161.2 (2003). A comparison of the October 2003 Index of Customers data to the January 2001 Index of Customers data reveals that the amount of firm capacity held by marketing affiliates has decreased during that period, while the amount of firm capacity held by other affiliates has increased during that period.¹⁵

¹⁴ A review of data from the 85 interstate natural gas pipelines and certificated storage companies that submitted an Index of Customers for October 2003, shows that 63 of them transport or store gas for their affiliates. Thirty-six pipelines transport gas for their marketing affiliates, which hold an average of 16 percent of the affiliated pipelines' capacity. Similarly, 13 pipelines with storage services "transport" gas for their marketing affiliates, which hold an average of 43 percent of the affiliates storage companies' capacity.

In addition, 33 pipelines transport gas for other (non-marketing) affiliates that hold an average of 42 percent of the affiliated pipelines' capacity, and 16 storage companies "transport" gas for their other affiliates, which hold an average of 46 percent of the affiliated storage companies' capacity.

Staff's review, which looked at all interstate natural gas pipelines that filed Index of Customers is more complete than an INGAA-sponsored study of select pipelines that showed, during 2000, that marketing and non-marketing affiliates of natural gas pipelines contracted for 14.4 percent of the capacity on their affiliated pipeline.

¹⁵ The January 2001 Index of Customers data shows that marketing affiliates held about 18 percent of affiliated interstate natural gas pipelines' firm capacity and non-marketing affiliates held an additional 19 percent of the affiliated pipelines' firm capacity. The October 2003 Index of Customers

of Stranded Costs by Public Utilities and Transmitting Utilities, Order No. 888, 61 FR 21540 (May 10, 1996), FERC Stats. & Regs., Regulations Preambles 1991–1996 ¶ 31,036 (Apr. 24, 1996) at 31,692; *order on reh'g*, Order No. 888–A, 62 FR 12274 (Mar. 14, 1997), FERC Stats. & Regs., Regulations Preambles 1991–1996 ¶ 31,048 (Mar. 4, 1997); *order on reh'g*, Order No. 888–B, 81 FERC ¶ 61,248 (1997); *order on reh'g*, Order No. 888–C, 82 FERC ¶ 61,046 (1998), *aff'd in relevant part sub nom.*, Transmission Access Policy Study Group v. FERC, 225 F.3d 667 (D.C. Cir. 2000), *cert. granted*, 69 U.S.L.W. 3574 (Nos. 00–568 (in part) and 00–809), *cert. denied* (No. 00–800) (U.S. Feb. 26, 2001).

⁸ Each reference to employees includes contractors, consultants and agents.

⁹ Order No. 636, Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation Under Part 284 of the Commission's Regulations, and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, FERC Stats. & Regs. ¶ 30,939 (1992), *order on reh'g*, Order No. 636–A, FERC Stats. & Regs. ¶ 30,950 (1992), *order on reh'g*, Order No. 636–B, 61 FERC ¶ 61,272 (1992), *aff'd in part, rev'd in part*, *United Distribution Cos. v. FERC*, 88 F.3d 1105 (D.C. Cir. 1996), *cert denied*, 137 L. Ed 2d 845, 117 S. Ct. 1723 (1997), *on remand*, Order No. 636–C, 78 FERC ¶ 61,186 (1997), *order on reh'g*, Order No. 636–D, 83 FERC ¶ 61,210 (1998).

¹⁰ We also have seen the entry of many financial institutions into the trading arena, *e.g.*, Morgan Stanley Capital Group, Inc., Bank of America, N.A., and UBS AG.

¹¹ As of October 1, 2003, the Commission has granted approximately 1300 market-based rate authorizations; nearly 880 of these were approved within the last five years. Of the authorizations granted within the last five years, about 500 were granted to investor-owned utilities and their affiliates.

¹² Since 1995, the Commission has received 66 public utility merger applications, 60 of which have been approved, one has been set for hearing and five have been withdrawn or terminated. Several mergers joined gas and electric companies, such as NiSource Inc. with Columbia Energy Group and Dominion Resources, Inc. with Consolidated Natural Gas Company.

¹³ In the matter of CMS Energy Company and Panhandle Eastern Pipeline Co. *et al.*, FTC File 991–0046, Analysis of Proposed Consent Order to Aid Public Comment.