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Lois D. Cashell,

Secretary.

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[Docket No. RM95-6-000]

Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines; Request for Comments on Alternative Pricing Methods

February 8, 1995.

The Federal Energy Regulatory Commission (Commission) requests comments on criteria to evaluate rates established through methods other than the traditional cost-of-service ratemaking method. The Commission's traditional approach to rate regulation sets an annual revenue requirement based on operating and capital costs occurring during a historical test period, adjusted for known and measurable changes expected to occur by the time suspended rates take effect. Rates are generally designed to recover the annual revenue requirement based on contract capacity entitlements and projected annual or seasonal volumes.

Recently, the Commission has received a number of requests from natural gas pipeline companies to approve rates based on various other pricing methods, some of which are cost-based, and some of which are not. For example, the Commission has approved a number of proposals for market-based rates for storage services.¹

¹ Avoca Natural Gas Storage, 68 FERC ¶ 61,045 (1994); Koch Gateway Pipeline Co., 66 FERC ¶ 61,385 (1994); Bay Gas Storage Company, LTD, 66 FERC ¶ 61,354 (1994); Petal Gas Storage Co., 64 FERC ¶ 61,190 (1993); Transok, Inc., 64 FERC

In *Stingray Pipeline Company*,² the Commission approved a one-year experimental interruptible transportation rate based on costs allocated to Stingray's interruptible service, subject to a price cap. In *KN Interstate Gas Transmission Company (KN)*,³ the Commission addressed KN's proposal to offer market-based rates and negotiated terms and conditions of service on its Buffalo Wallow System. Most recently, Florida Gas Transmission Company's section 4 filing in Docket No. RP95-103-000 included a "Market Matching Program," under which shippers would have the option of negotiating rates and terms of service different from the tariff rates and terms of service. Florida Gas also proposed an experimental inflation indexing mechanism for rate changes, using cost-of-service rates as the starting point.

The Commission is interested in developing a framework for analyzing proposals involving alternative pricing methods for natural gas pipelines. There are a number of different ratemaking methods that could be used instead of the traditional individual company embedded cost-of-service method. In addition to market-based pricing, there are a number of cost-based methods that vary from the individual company cost-of-service method traditionally used by the Commission. The Commission recognizes that it may be necessary to develop different criteria for evaluating alternative pricing proposals, depending upon the method proposed. To this end, the Commission's staff has prepared a paper, which is attached, proposing criteria for the evaluation of proposals for market-based rates. The staff paper draws from basic antitrust market power analysis, that has been used in the past by the Commission and in other contexts, to develop a proposed analytical framework to use in evaluating gas pipeline market-based rate proposals. The Commission is interested in receiving comments on all aspects of the staff paper, including the following:

1. a. Under what circumstances are market-based rates appropriate for natural gas pipelines and services regulated by the Commission?
- b. Please identify and discuss any legal issues, beyond those discussed in the staff paper, that should be considered.
2. a. Are the Department of Justice/Federal Trade Commission Horizontal Merger Guidelines, from which the staff proposal is drawn, the best framework to evaluate market

¶ 61,095 (1993); Richfield Gas Storage System, 59 FERC ¶ 61,316 (1992).

² 66 FERC ¶ 61,202 (1994).

³ 68 FERC ¶ 61,401 (1994).

power in the interstate natural gas pipeline context?

b. Are there other approaches to evaluating market power that would be less burdensome?

3. a. Are the criteria proposed in the staff paper reasonable, too strenuous, or not strenuous enough?

b. Should the Commission use a different standard for different types of service, such as mainline transmission, storage, or market hub services?

4. a. Should the Commission consider treating companies with a small market share differently from larger or dominant sellers, and if so, under what circumstances?

b. How should the Commission view cases in which large sellers face large buyers (that is, where a single buyer represents a large share of a transporter's market)?

c. Can a buyer's monopsony power mitigate a seller's market power, and if so, how should the Commission analyze such cases?

5. Do commenters agree or disagree with staff's analysis that capacity release does not constitute a good alternative to firm transportation?

6. What procedures should the Commission employ to evaluate market-based rate proposals; should the Commission change its current policy of using declaratory orders or ruling on *pro forma* tariff sheets?

7. Are there particular requirements the Commission could impose that would increase the availability of shippers' service alternatives and mitigate the market power of a natural gas company that would not otherwise qualify for market-based pricing?

8. Are there regulatory policies or ratemaking methods that would better serve the Commission's regulatory goals of flexible, efficient pricing in today's environment? For example, should the Commission focus on "backstop" proposals, where pipelines would be free to negotiate rates and terms of service, so long as customers could always choose service under traditional cost-of-service rates and terms of service?

In addition, the Commission also invites comments on the criteria for evaluating incentive rate proposals. While the Commission currently has a policy for evaluating cost-based incentive rate proposals, to date no natural gas company has submitted a proposal in response to the Commission's invitation to submit incentive rate proposals for an experimental period. The Commission's October 30, 1992 policy statement on incentive regulation defined the essential elements of an incentive ratemaking policy and set guidelines for incentive rate proposals.⁴ The policy statement adopted two general principles: That incentive regulation should encourage efficiency, and that starting rates under incentive regulation must conform to the Commission's

⁴ Policy Statement on Incentive Regulation, 61 FERC ¶ 61,168 (1992).