

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Suedeem G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

Northwest Pipeline Corporation

Docket No. RP05-379-001

ORDER ON REHEARING

(Issued June 15, 2007)

1. On October 4, 2006, the Commission issued an order¹ addressing Northwest Pipeline Corporation's (Northwest) petition for declaratory order requesting that the Commission terminate a controversy by declaring that Northwest correctly interprets section 21.3 of its tariff concerning the calculation of certain facilities reimbursement payments for the Grays Harbor Lateral facilities that were built to supply natural gas to an electric generating plant planned by Duke Energy Grays Harbor, LLC.² The October 4 Order granted Northwest's petition in part and denied Northwest's petition in part. On November 3, 2006, Northwest filed a request for rehearing of the October 4 Order. For the reasons discussed below, the Commission grants in part, and denies in part, rehearing.

Background

2. The Facilities Reimbursement provisions at section 21.3 of Northwest's tariff require shippers to reimburse Northwest for any receipt or delivery facilities constructed by Northwest either by a (1) lump-sum payment at inception, upon completion of

¹ *Northwest Pipeline Corporation*, 117 FERC ¶ 61,014 (2006) (October 4 Order).

² On April 16, 2001, Northwest and Duke Energy Grays Harbor, LLC entered into a firm transportation agreement and a facilities agreement relating to the proposed Grays Harbor Lateral. On April 19, 2002, Duke Energy Grays Harbor, LLC assigned the transportation agreement to Duke Energy Trading and Marketing, LLC (DETM).

construction, or (2) a facilities surcharge designed to recover the cost-of-service over the term of service, subject to a shipper's right to terminate such a facilities surcharge at any time by making a lump-sum payment reflecting the then remaining net book value of the facilities. For the Grays Harbor Lateral facilities, Northwest and DETM agreed to the facilities surcharge option under section 21.3(b), and Northwest had billed DETM under this option for the period November 1, 2002, through December 31, 2004.

3. On December 21, 2004, DETM invoked its right to terminate the facilities surcharge pursuant sections 21.3(e) and (f) of Northwest's tariff and requested an invoice for the then remaining net book value, including related income taxes. DETM indicated that it invoked its right to terminate the surcharge because it cancelled its Grays Harbor Generating Plant and there were no alternative uses for the Grays Harbor Lateral constructed by Northwest to serve said plant. Northwest submitted an invoice to DETM reflecting a lump-sum termination payment of approximately \$124 million as of December 31, 2004. DETM disputed Northwest's calculation of the termination payment and claimed it owed Northwest approximately \$93 million. According to Northwest, the lower termination payment calculated by DETM was due to a disagreement over the interpretation of the term "related income taxes" found in section 21.3 of the tariff. Northwest asserted that, in calculating a termination payment, the term contemplates only future tax benefits. DETM, on the other hand, contended that "related income taxes" contemplates both past and future tax benefits. Both parties used the same net book value of approximately \$87 million in their calculations. The termination payment is determined by adding the net book value to the current tax liability and then subtracting the tax benefits of tax depreciation. Under DETM's interpretation, including both past and future tax benefits would result in a lower current tax liability and a higher tax benefit of tax depreciation resulting in a termination payment reduced by approximately \$31 million from that calculated by Northwest.

4. On January 20, 2005, DETM paid approximately \$93 million to Northwest for the termination payment. Northwest stated that since January 2005, it has billed DETM for the \$31 million outstanding balance, plus interest on the unpaid amount. As of June 15, 2005, DETM still had remitted only \$93 million for the termination payment. On June 16, 2005 Northwest filed a petition for declaratory order. Northwest requested that the Commission address the issue arising under its tariff concerning the definition of "related income taxes" by issuing an order declaring that the prospective determination of "future tax benefits resulting from tax depreciation of such facilities," under section 21.3(a) of Northwest's tariff, likewise applies in the determination of "related income taxes" under sections 21.3(e) and (f) of Northwest's tariff.

5. On March 31, 2006, a data request was issued directing Northwest to file certain accounting and tax information so that the Commission Staff could complete the analysis

of the issues raised by Northwest and DETM. Northwest filed its data response on April 27, 2006.

6. On October 4, 2006, the Commission issued an order granting Northwest's petition in part and denying Northwest's petition in part. Based upon a review of the pleadings in the proceeding, and the supplemental tax and accounting information filed by Northwest pursuant to the data request, the Commission found that the proceeding could not be resolved simply by answering the narrow question posed by Northwest in its petition. The Commission found that determining that only "future tax benefits" are contemplated by the term "related income taxes," as requested by Northwest, would not achieve an appropriate result. Similarly, the Commission found that the interpretation advocated by DETM, including both future and past tax benefits in determining "related income taxes," also would not achieve an appropriate result.

7. The Commission found that neither Northwest nor DETM had properly determined the facilities reimbursement amount. The Commission found that the termination payment, if properly determined, should leave Northwest with enough cash to recoup its remaining capital investment in the Grays Harbor facility, after taking into consideration the payment of taxes on the termination payment and net present value of the future tax benefits on the remaining tax basis existing at the time of the buyout. Under this premise, Northwest's termination billing of \$124,422,232 would allow it to collect more from DETM than needed to recover its capital investment and related income taxes on the Grays Harbor facility. On the other hand, the \$93,962,131 DETM asserted is the correct amount of the termination payment would lead to an under-recovery of Northwest's capital investment and related income taxes on the Grays Harbor facility.

8. On November 3, 2006, Northwest filed a request for rehearing of the October 4, 2006 Order.

Northwest's Request for Rehearing

9. Northwest contends that the October 4 Order does not address any of the arguments regarding the appropriate interpretation of section 21.3 of its tariff; instead, Northwest argues that the order determines what it deems an appropriate result outside the four corners of the tariff.

10. Northwest asserts that the termination charge provided for in section 21.3 of its tariff is the lawful rate on file with the Commission per section 4 of the (Natural Gas Act). Northwest submits that a plain reading of section 21.3 and, in particular, the plain meaning of the term "related income taxes" as used therein, dictates that only "future tax benefits" be reflected in the calculation of said termination charge. Northwest contends

that while the Commission may disagree with the result prescribed by the filed tariff, aside from the requirement that it support any different result with a reasoned decision addressing the countervailing legal arguments and addressing its departure from its own precedent, the fundamental "filed rate" and "antireparation" precepts of the NGA dictate that it can only do so on a prospective basis. Northwest argues that the Commission cannot retroactively change the termination charge prescribed by Northwest's tariff.

11. Northwest asserts that the Commission's order ignores the provisions of Northwest's tariff and the plain meaning of the terms defined therein. Northwest submits that common principles of statutory and contract construction teach us that, under the principle of *ejusdem generis*, specific words identify and restrict the meaning of general words. Northwest states that according to the manifest logic of this principle, if general words were intended to be used in an unrestricted sense, there would be no mention of the specific words. Northwest asserts that a similar principle of contract construction requires that a term given meaning in one part of a contract is presumed to retain that same definition throughout the contract, unless otherwise indicated.

12. Northwest argues that any interpretation that would deem the definition of the term "related income taxes" to apply only in section 21.3(a) and thereby be limited to the context of reimbursement at inception, simply illustrates the inherent logic of *ejusdem generis*. Northwest asserts that had the intent been for the general term "related income taxes" to have an unrestricted sense, free to take on a different meaning wherever used, there would be no need for, nor mention of, the specific words defining that general term where used in the first instance. Northwest submits that this would be to essentially suggest that specific words in section 21.3(a) speaking of "future tax benefits" are unnecessary or superfluous.

13. Northwest argues that this specific defining phrase has been approved by the Commission as part of Northwest's tariff and provides a more specific explication of exactly what the general term "related income taxes" means. Northwest contends that the general term "related income taxes" thus has been given a specific meaning in accordance with *ejusdem generis*, and these specific defining words must be read to identify and restrict the meaning of the general term "related income taxes," wherever that general term appears.

14. Northwest asserts that contrary to any suggestion that its interpretation of its tariff is at odds with its purpose by somehow creating a "windfall" from such a lump-sum reimbursement, the purpose of section 21.3 is that which is expressed in the clear, unambiguous terms of the tariff. That is, the "related income taxes" to be included in any section 21.3 reimbursement is defined, and that definition expressly prescribes a forward-looking calculation which specifies the use of certain "future tax benefits" in said calculation. Northwest argues that one need go no further to divine the purpose of

section 21.3, much less to reject unsupported allegations that this Commission-approved tariff somehow results in a "windfall."

15. Northwest argues that contrary to the plain, unambiguous language of section 21.3 that expressly calls for use of "future tax benefits" from tax depreciation, DETM would have the Commission rewrite that phrase to say "past and future tax benefits" and then to throw in "ADIT" reflecting the same past depreciation tax benefits for double measure. While Northwest remains doubtful that the Commission intended any such illogical result that would produce a termination charge substantially below net book value, Northwest contends that the order nevertheless has strayed from a clear and unambiguous reading of these Commission approved provisions of Northwest's Tariff.

16. Northwest argues that its interpretation of its tariff is supported not only by a plain reading of the subject "Facilities Reimbursement" provisions, but also by Commission precedent in an earlier Northwest case, *i.e.*, the *Columbia Gorge case*.³ Northwest argues that like here, DETM in *Columbia Gorge* was subject to an incremental facilities charge (similar to the monthly facilities surcharge it has been paying for the Grays Harbor Lateral) designed to recover the cost-of-service of the additional facilities over the term of service. Northwest submits that like here, DETM had the option to pay a post-inception reimbursement of the net book value of the facilities plus associated taxes. Northwest contends that the definition of associated tax liabilities described in the *Columbia Gorge* order closely resembles the definition of "related income taxes" in section 21.3 of the tariff, "*i.e.*, the difference between Transporter's current federal and state tax liability resulting from Shipper's reimbursement to Transporter of the actual construction costs of such facilities and the present value of Transporter's future tax benefits resulting from tax depreciation on such facilities, grossed-up for income taxes."

17. Northwest states that should the Commission on rehearing deny its request and continue to call for recognition of both past and future tax benefits, Northwest submits that the Order's method of calculating that result is in error. Specifically, Northwest asserts that DETM's calculation needs to be corrected as follows:

- (a) DETM's calculation uses a "Depreciable Cost" of \$92,841,879 which is in error. DETM's calculation needs to be corrected to use the actual depreciable basis of \$90,180,814.

³ *Northwest Pipeline Corp.*, 87 FERC ¶ 61,227, *reh'g denied*, 89 FERC ¶ 61,172 (1999) (*Columbia Gorge*).

(b) DETM's calculation assumes "Period 1" to be 2003. DETM's calculation needs to be corrected to reflect the fact that these assets were placed in service in 2002, not 2003.

(c) DETM's calculation reflects the tax effect of total tax depreciation taken in the pre-termination years. DETM's calculation needs to be corrected to properly take into account the tax effect of pre-termination book depreciation already included in the pre-termination cost-of-service charges.

Northwest asserts that revising DETM's calculation for the above three corrections produces a termination charge of \$106,116,620. Northwest asserts that should the Commission continue to impose upon Northwest an obligation to return vast tax benefits upon the calculation of the subject termination charge, the Commission should further direct that these three additional corrections be made to DETM's calculation. Northwest asserts that any termination charge less than \$106,116,620 simply would not keep Northwest whole per the October 4 Order's approach, much less conform to any concept of equity which the Order seems to be invoking.

Discussion

18. The Commission rejects Northwest's argument that the plain meaning of its tariff supports its interpretation that when calculating the termination charge pursuant to sections 21.3(e) and (f) related income taxes would include only future tax benefits rather than both past and future tax benefits. Northwest claims that since section 21.3(a) of the tariff defines related income taxes as including only future tax benefits, such definition applies throughout its tariff including when determining the termination charge pursuant to sections 21.3(e) and (f). The Commission finds that Northwest is incorrect in its assertion that the term "related income taxes" is defined the same way throughout its tariff. Section 21.3(a) is the only section of Northwest's tariff where "related income taxes" is followed by a parenthetical expression explaining that related income taxes includes future tax benefits. Such an approach makes sense where Northwest is describing what happens in the event that a facilities reimbursement payment is made by a shipper in a lump sum when the facilities are first completed. At that time the only tax benefits that Northwest may derive due to depreciation are future tax benefits. In contrast, when a shipper chooses to cease paying the facilities reimbursement surcharge and make a termination payment, certain tax benefits associated with depreciation already would have been realized by Northwest and other tax benefits would not be realized until a future date.

19. If, as Northwest asserts, the term "related income taxes" were to be a consistently defined term throughout its tariff it could have provided this by defining "related income taxes" in the definition section of the tariff or, at the very least, stated in section 21.3 of

its tariff, that “related income taxes” would retain the same meaning throughout the facilities reimbursement provision of its tariff. Thus, contrary to Northwest’s argument, the definition of “related income taxes” is not plain within the four corners of the document, especially when the issues of tax liability and depreciation would differ depending on whether a shipper paid an initial lump sum facilities reimbursement payment or chose to pay the facilities reimbursement surcharge over time.

20. The Commission also disagrees with Northwest’s argument that the *Columbia Gorge* case supports its interpretation of section 21.3 of its tariff here. While it is true that the *Columbia Gorge* case dealt with facilities built by Northwest for DETM that would be the subject of a facilities reimbursement payment, the similarity ends there. In that case, the Commission did not accept any specific tariff language for facilities reimbursement payments and was not called on to interpret ambiguous language as we have been here. Rather, in the *Columbia Gorge* case, DETM specifically agreed in its facilities agreement that if it chose to terminate paying the facilities surcharge and make a lump sum payment the calculation of such termination payment would only include the present value of future tax benefits due to depreciation. The fact that DETM specifically agreed to a certain type of tax treatment for facilities reimbursement in a service agreement for different facilities does not mean that it applies to the interpretation of a tariff provision that, while applicable to DETM in this case, is a tariff provision that is applicable to any shipper who has facilities built for it by Northwest. Moreover, if in fact, Northwest wanted to have related income taxes treated as only including future tax benefits from depreciation, it should have obtained an agreement from DETM similar to that in the *Columbia Gorge* case. Accordingly, the Commission denies that portion of Northwest’s request for rehearing based on Northwest’s interpretation of the tariff language.

21. The Commission, however, will grant Northwest’s request for rehearing in part with respect to the calculation of the termination payment set forth by the Commission in the October 4 Order. The Commission agrees with Northwest that (1) the calculation of the termination payment must be made using the correct depreciable cost amount as its starting point, (2) the termination payment calculation must be made using the proper date that the facilities were placed in service, and (3) that the tax effect of book depreciation in pre-termination cost-of-service charges should be taken into account in determining the contract termination payment. The Commission finds that since Northwest includes the pre-termination tax depreciation benefit in its calculation of the termination payment, as shown on Schedule 3 to its rehearing request, it must include the pre-termination book depreciation in the calculation to make it whole. By using pre-termination tax and book depreciation in its calculation, the contract termination payment is reduced by the amount of ADIT existing at the time of the contract termination as ordered by the Commission in its October 4 Order. Granting rehearing with respect to

these aspects of the calculation methodology is consistent with the principle discussed in the October 4 Order of properly compensating Northwest for the contract termination while not permitting a windfall to Northwest at the expense of DETM.

The Commission orders:

Northwest's request for rehearing is granted in part and denied in part as discussed above.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.