

135 FERC ¶ 61,085
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Marc Spitzer, Philip D. Moeller,
John R. Norris, and Cheryl A. LaFleur.

Northern Natural Gas Company

Docket No. RP10-841-001

ORDER DENYING REHEARING

(Issued April 28, 2011)

1. On January 10, 2011, Northern Natural Gas Company (Northern Natural) filed a request for rehearing of the Commission's December 10, 2010 order rejecting tariff sheets filed by Northern Natural pursuant to section 4 of the Natural Gas Act (NGA).¹ Those tariff sheets proposed to allow Northern Natural to resell, at market-based rates, capacity for which Northern Natural had previously received authorization pursuant to section 4(f) of the NGA² to sell only pursuant to the initial shippers' contracts subscribing to such capacity. The December 2010 Order rejected this filing because, as the storage capacity was already constructed, Northern Natural's proposal could not satisfy the threshold requirements of section 4(f) that the market-based rates be "necessary to encourage the construction of the storage capacity."³ The Commission further found that Northern Natural failed to provide any other justification under the Commission's regulations for permitting it to establish market-based rates for the resale of this capacity. As discussed below, the Commission denies the request for rehearing.

Background

2. The background of this matter is discussed in detail in the December 2010 Order and is therefore only summarized here. Northern Natural filed the subject tariff sheets on

¹ *Northern Natural Gas Co.*, 133 FERC ¶ 61,210 (2010) (December 2010 Order).

² Energy Policy Act of 2005, Pub. L. No. 109-58, Section 312, 119 Stat. 594, 688 (2005) (to be codified at 15 U.S.C. § 717c(f)(1)(A)) (hereinafter section 4(f)).

³ *Id.*

June 11, 2010, to incorporate into Northern Natural's tariff provisions for the resale at market-based rates of certain Redfield storage capacity that was sold in 2006 pursuant to an open season auction authorized under section 4(f) of the NGA.⁴ The June 11 tariff filing also contained more general modifications to Northern Natural's existing auction provisions for other types of capacity sales. The filing was protested by numerous shippers holding contracts for the Redfield expansion capacity at issue here. After completion of a technical conference and the submission of comments, the December 2010 Order rejected Northern Natural's proposal to resell at market-based rates any of its expansion Redfield storage capacity turned back to Northern Natural or that became available when the contracts expire. However, the December 2010 Order clarified that Northern Natural could file rates for the resale of capacity that was turned back before the expiration of the 20-year contracts, but the rate for such resale may not exceed rates in the current 20-year Redfield storage contracts. The December 2010 Order thus provided for remarketing the Redfield expansion storage capacity through an auction procedure, in which the reserve price⁵ for such an auction could be set no higher than the current maximum tariff rate governing Redfield storage.

3. The order held that Northern Natural's filing conflicted with the 2006 Declaratory Order's finding that "Northern Natural proposed market-based rates only for the rates in the precedent agreements signed during the open season, and therefore, the use of market-based rates does not apply to sales of this storage capacity outside of these precedent agreements."⁶ The Commission also stated that Northern Natural appeared to have assumed that because it obtained market-based rates for its initial contract rates for the Redfield expansion capacity, it was entitled to obtain market-based rates for all subsequent resales of that capacity simply by submitting a filing to meet the consumer protection requirements of section 4(f) for such resales.

4. The December 2010 Order disagreed with this interpretation of section 4(f). It held that in order to obtain market-based rates under section 4(f), the pipeline must show that the storage capacity for which market-based rates is being sought is related to new facilities and demonstrate that the granting of market-based rates is "necessary to encourage the construction of the storage capacity." The Commission found that Northern Natural could not satisfy this threshold requirement because it could not show that the market-based rates it was seeking were necessary to encourage construction of storage capacity since Northern Natural had already constructed the capacity at issue.

⁴ *Northern Natural Gas Co.*, 117 FERC ¶ 61,191 (2006) (2006 Declaratory Order).

⁵ The lowest price at which Northern is obligated to sell the capacity.

⁶ 2006 Declaratory Order, 117 FERC ¶ 61,191 at n.4.

Moreover, the Commission found that Northern Natural had not provided any other justification under the Commission's regulations or policy for its request for market-based rates for the resale of the Redfield storage capacity.⁷

Discussion

5. Northern Natural filed a request for rehearing of the December 2010 Order asserting that: (1) the Order was inconsistent with a September 2007 Order's⁸ interpretation of the 2006 Declaratory Order stating that Northern Natural could file to extend its market-based rates; (2) the December 2010 Order's interpretation of section 4(f) had no merit, and if valid, the failure to apply this interpretation prospectively was unlawful; and (3) the imposition of a reserve and price cap and termination of the technical conference and rejection of Northern Natural's tariff filing were arbitrary and capricious.

A. Alleged Inconsistency of the September 2007 and December 2010 Orders

6. Northern Natural argues the September 2007 Order contemplated that Northern Natural could apply to extend its market-based rate authority under section 4(f) beyond the expiration of the 20-year contracts, and cites the following language from that Order:

However, if sometime before the expiration of the contract, Northern proposes additional protections against the exercise of market power relating to the sale of capacity after the expiration of the primary term of the service agreements, the Commission will determine at that time whether the protections are adequate and the extent to which market-based rates should apply beyond the primary term of the service agreement.... The declaratory order left this possibility open, which Northern recognizes in the final phrase of its ROFR provision. . . . Northern's filing is consistent with the limitations established in the declaratory order.⁹

⁷ See 18 C.F.R. §§ 284.502-504 (allowing market-based rates upon a showing of a lack of market power).

⁸ Citing *Northern Natural Gas Co.*, 120 FERC ¶ 61,233 (2007) (September 2007 Order).

⁹ *Id.* P 18 and 19 (footnote omitted).

7. Northern Natural asserts the December 2010 Order incorrectly states that the matter under discussion here involved a threshold issue that was not raised by the parties.¹⁰ It states that in the pleadings leading to the September 2007 Order Xcel Energy Services Inc. (Xcel) argued that under the 2006 Declaratory Order Northern had no ability to extend its section 4(f) market-based authority for the Redfield expansion, and that this argument was rejected by the quoted language of the September 2007 Order. Northern therefore concludes that the December 2010 Order denying Northern Natural's efforts to extend its market-based authority under section 4(f) is inconsistent with the September 2007 Order's conclusion, and therefore the latter order was not reasoned decision making.

8. The September 2007 Order did not directly address the extension of market-based rates. Rather, that Order dealt only with the question of whether a Right of First Refusal (ROFR) would attach to the existing contracts at the expiration of those contracts. The Commission held that such a ROFR right would attach if the tariff provided that the shipper would be paying the maximum tariff rate at the end of the contract. The September 2007 Order addressed a possible extension of market-based rates only by acknowledging (through the quoted language) that if Northern Natural had obtained market-based rates for any post-initial-contract capacity, the Commission would determine at that point whether the ROFR would apply. The Commission did not assure Northern Natural could obtain market-based rates for such capacity pursuant to section 4(f). It stated only that if Northern Natural did obtain market-based rate authority after the initial contracts expired, the Commission would then determine whether the ROFR would apply. In fact, the September 2007 Order specifically recognized that the 2006 Declaratory Order had not permitted market-based rates upon contract expiration: "[T]he Commission's actions in the declaratory order do not extend to permitting Northern to charge market-based rates for any subsequent sales of the expansion storage capacity."¹¹ The September 2007 Order thus reiterated the then clear limitation on the Northern Natural's section 4(f) rates, while leaving open *the possibility* of extending market-based rates beyond the primary terms of the service agreement; the order did not, however, guarantee that such a request would be granted, nor did it analyze whether such a request would be permissible under section 4(f). Even if the September 2007 Order could be interpreted to authorize a possible extension of market-based rates, the September 2007 Order did not analyze whether such rates would be available under

¹⁰ See December 2010 Order, 133 FERC ¶ 61,210 at P 9, which states: "Upon review, the Commission has identified a threshold issue that was not raised by the parties."

¹¹ September 2007 Order, 120 FERC ¶ 61,233 at n.7 (citing 2006 Declaratory Order, 117 FERC ¶ 61,191, at P 22, *reh'g denied*, 119 FERC ¶ 61,072 (2007)).

section 4(f). In the December 2010 Order, the Commission did undertake such an analysis, and found that section 4(f) did not permit a grant of market-based rates for previously constructed capacity.

9. Both the information developed through the technical conference and further review of the threshold question were brought to bear in determining whether Northern Natural's June 11, 2010 tariff filing proposed consumer protections that were adequate, and whether market-based rates should apply beyond the primary term of the original service agreements (or to the resale of any turned-back capacity). While the December 2010 Order did not mention the September 2007 Order, it did address to what extent the 2006 Declaratory Order left open the possible extension of the Redfield expansion section 4(f) rate authority, and whether such an extension is permissible under section 4(f).

10. In conclusion, the December 2010 Order directly addressed the possibility of extending section 4(f) market-based rates based for the first time on an extensive analysis of the December 2006 Declaratory Order and the underlying statute and regulations. The September 2007 Order mainly addressed Northern Natural's tariff filing to implement the 2006 Declaratory Order with respect to its ROFR provision. Even if the September 2007 Order could be interpreted as allowing an extension of market-based rates, in the context of the subject rehearing request the Commission again concludes that December 2010 Order has the correct interpretation. The chief focus in the September 2007 Order was whether Northern Natural's tariff filing regarding ROFR was "consistent with the limitations established in the declaratory order."¹² The issue of whether Northern Natural could extend market-based rates upon contract expiration was, at best, peripheral to the consideration of the proposed tariff provisions, and after full consideration of the issues, we again find that such an extension of market-based rates is not permissible under section 4(f).

B. December 2010 Order's Application of Section 4(f)

11. Northern Natural's second argument is that the December 2010 Order incorrectly interprets section 4(f), is unduly restrictive, and inhibits investment in natural gas storage projects. Northern Natural states that section 4(f)(1) addresses "market-based rates for new storage capacity" and that section 4(f)(1)(A) states that "market-based rates are in the public interest and necessary to encourage the construction of storage capacity in the area needing storage services."¹³ Northern Natural argues that neither statute nor regulation limits market-based rates to any particular contract term or limits satisfaction

¹² *Id.* P 18 and 19 (footnote omitted).

¹³ Section 4(f)(1) and section 4(f)(1)(A) (emphasis added).

of the customer protection requirement in section 4(f)(1)(B) to the time prior to construction of the market-based rate storage capacity. Northern Natural further argues that while the Commission is certainly free, prior to the construction of the new storage capacity, to consider the customer protection issue relating to resales of market-based capacity, there is no statutory language that prevents the Commission from addressing this issue after construction.

12. Northern Natural ignores, however, both the threshold requirements of section 4(f) and the terms of its initial request for market-based rates. First, section 4(f) requires that market based rates be for “new” storage capacity and that the Commission find that the grant of market-based rates is “necessary to encourage the construction of the storage capacity.” Congress passed section 4(f) to encourage the development of storage that would not be developed without market-based rates. Congress was not establishing a mechanism by which pipelines could seek market-based rates for already constructed storage.

13. Second, as discussed in the December 10 Order, prior to seeking certification for the expansion of the Redfield storage capacity, Northern Natural requested market-based rates for the Redfield storage capacity, but only for the initial auction of capacity and for the shippers that signed contracts as a result of that auction. Northern Natural’s position was that a limited grant of market-based rates would be sufficient to provide it with the incentive to construct the storage facility.¹⁴ In the 2006 Declaratory Order and subsequent certificate order, the Commission found that the market-based rates requested by Northern Natural (and as limited by Northern Natural to the original auction) were for “new” storage capacity and were necessary to encourage the development of that storage capacity.

14. However, as enunciated in the December 2006 Declaratory Order, the market-based-rate authority for the Redfield storage capacity did not extend to the resale of that capacity upon expiration or termination of the initial contracts. As such, Northern Natural’s request in this Docket No. RP10-841-001 to extend its section 4(f) rate authority cannot be sustained under section 4(f) because no “new” storage capacity is

¹⁴ “The prospective FDD customers are willing to pay market-based rates for the terms reflected in their binding precedent agreements and, in exchange, Northern will make the required investment and thereby assume the operational risk inherent in the 2008 FDD Expansion.” Petition of Northern Natural Gas Company for Declaratory Order, July 17, 2006, p. 31-32.

being constructed and the market-based rates requested are not necessary to encourage the development of new storage infrastructure.¹⁵

15. We agree with Northern Natural that the statute and the Commission's regulations do not limit market-based rates under section 4(f) to any particular contract term or limit satisfaction of the customer-protection requirement to the time prior to construction of the market-based rate storage capacity. Pipelines may request prior to construction market-based rates authority that will extend beyond the initial auction or contracts. Indeed, such non-limited market-based rates under section 4(f) may be particularly appropriate for a storage project that is not completely subscribed during a cost-based open season where the pipeline demonstrates that it requires market-based rates for future sales in order to make the project economic.¹⁶ However, the pipeline must request section 4(f) approval for continuing market-based rate authority prior to construction of the project. Here Northern Natural apparently did not require, and, in any event, did not request, market-based rates for future sales at the time it constructed the project. As a result, the Commission had no reason to review whether the risks of the project warranted market-based rates for resales, particularly since the project was fully subscribed during the initial auction with long-term contracts.¹⁷

16. Other pipelines that have undertaken natural gas storage projects pursuant to a declaratory order under section 4(f) have proposed at the outset of the proceeding that market-based rates for resales of capacity were necessary to support their projects, and have advanced consumer protection provisions that would apply to the resale, as well as

¹⁵ While we find that Northern Natural cannot obtain authorization for market-based rates for resale of the 2008 Redfield storage capacity pursuant to section 4(f), Northern Natural may seek market-based rate authority for such resales pursuant to the requirements of sections 284.502–.503 of the Commission's regulations, including an absence of market power. *See* 18 C.F.R. § 284.502–.503 (2010).

¹⁶ *Rate Regulation of Certain Natural Gas Storage Facilities*, Order No. 678, 71 Fed. Reg. 36,612 (June 27, 2006), FERC Stats. & Regs. ¶ 31,220, at P 129 (2006) (the applicant can “present evidence that it offered its capacity at cost-based rates through an open season and was unable to obtain sufficient long-term commitments at those cost-based rates”).

¹⁷ Despite the clear language in the December 2006 Declaratory Order, Northern Natural apparently assumed it had a right to extend the authority to charge market-based rates to resales without having ever presented that issue to the Commission.

to the initial sale, of such section 4(f) capacity.¹⁸ Northern Natural, on the other hand, eschewed presenting such a request or any consumer protection provisions for turn-back capacity at the declaratory order stage. By demonstrating a need for future sales at market-based rates *ab initio*, these other pipelines satisfied the threshold section 4(f) requirements.

17. We disagree with Northern Natural's assertion that while the Commission is certainly free, prior to the construction of the new storage capacity, to consider customer protection issues relating to resales of that capacity at market-based rates, there is no statutory language that prevents the Commission from addressing this issue after construction. However, as discussed above, section 4(f) applies only to "new" storage capacity and applies only when the pipeline can demonstrate that market-based rates are necessary to encourage the development of new storage infrastructure. Because Northern Natural's request for market-based rates for any resales of the expansion capacity was made after the storage project was constructed, the request cannot meet these threshold requirements under section 4(f) for authority to charge market-based rates. Moreover, in its section 4 filing, Northern Natural presented only a "customer protection" plan for such resales; it failed to provide any evidence to justify the authorization of market-based rates for such resales.¹⁹

18. Northern Natural further asserts that the December 2010 Order may deprive it of an opportunity to recover the costs of the Redfield expansion by denying it the opportunity to utilize market-based rates under section 4(f) once the 20-year Redfield

¹⁸ See *Southern Star Central Gas Pipeline*, 131 FERC ¶ 61,154, at P 41-43 (2010); *Columbia Gas Transmission Corporation*, 126 FERC ¶ 61,237, at P 32-38 (2009); *Texas Gas Transmission, LLC*, 122 FERC ¶ 61,190, at P 38-40 (2009).

¹⁹ There may be good reasons for approving market-based rates for initial fully subscribed auctions and not approving market-based rates for subsequent resales. While the initial auction may protect the shippers during an open season, authorizing market-based rates for resales when a pipeline has market power may provide an incentive for the pipeline to limit construction of future projects in order to ensure that scarcity pushes up the price for the resale. See *Promotion of a More Efficient Capacity Release Market*, Order No. 712-A, ¶ 31,284, at P 29-37 (2008) (importance of maintaining "proper incentives to construct needed pipeline infrastructure"), *aff'd*, *Interstate Natural Gas Ass'n v. FERC*, 617 F.3d 504, 510-511 (D.C. Cir. 2010) ("FERC offered another important reason for treating pipelines and shippers differently. If pipelines could charge market-based rates in the short-term market, they might withhold construction of new capacity to take advantage of the opportunity to earn scarcity rents in the short-term market").

expansion contracts expire, or if some of the capacity is turned back to Northern Natural before that time. Northern Natural will not be deprived of an opportunity to recover its legitimately incurred costs of the Redfield project upon contract expiration. Northern Natural can recover such costs through a cost-based rate and can make any necessary filings under section 4 of the NGA to revise its rate to provide it a reasonable opportunity to recover any remaining costs for these facilities.

19. Northern Natural also asserts the Commission only should apply the December 2010 Order prospectively. Northern Natural suggests that it might not have proceeded with the construction of the expanded Redfield storage capacity if it had known of the limitations on its section 4(f) market-based rate authority ultimately adopted by the December 2010 Order.

20. As discussed, the 2006 Declaratory Order made abundantly clear that Northern Natural was not authorized to charge market-based rates upon contract expiration. The order stated that “Northern Natural meets the criteria necessary to negotiate market-based rates for the shippers that submitted winning bids in the 2006 Open Season and that signed precedent agreements.”²⁰ The Declaratory Order made this point more explicit, stating: “Northern Natural proposed market-based rates only for the rates in the precedent agreements signed during the open season, and therefore, the use of market-based rates does not apply to sales of this storage capacity outside of these precedent agreements.”²¹ Northern Natural proceeded with the project despite this explicit statement of the extent of the Commission’s ruling. Northern Natural did not lack notice of the rate implications of its filing. Moreover, as discussed previously, the September 2007 Order recognized the limitations placed on Northern Natural’s market-based rates and nothing in that Order guaranteed to Northern Natural that such an application would be found acceptable under section 4(f) when the Commission actually considered such an application in a proceeding.

C. Additional Issues

21. Northern Natural raises two additional points regarding the resale of capacity. It asserts the Commission erred in capping the rate Northern Natural may charge for the resale of capacity at the price of the capacity contained in the initial 20-year contract. Northern Natural’s second argument is that the Commission incorrectly imposed a reserve price of not more than cost of the capacity at issue. Northern Natural states that after the technical conference it agreed to higher resale terms with Xcel, the primary user of the Redfield expansion capacity, and the Commission’s refusal to honor this deal

²⁰ 2006 Declaratory Order, 117 FERC ¶ 61,191 at P 9.

²¹ *Id.* P 9 n.4

which was formulated in the context of the current proceeding would arbitrarily preclude it from selling capacity at that price.

22. In the 2006 Declaratory Order, the Commission authorized market-based rates for the initial sale of the capacity to Xcel and the other shippers. But as we have noted previously, the Commission specifically stated that such rates would not apply to resales: “Northern Natural proposed market-based rates only for the rates in the precedent agreements signed during the open season, and therefore, the use of market-based rates does not apply to sales of this storage capacity outside of these precedent agreements.”²² Therefore, the Commission did not approve market based rates for resale of the Xcel capacity, nor can Northern Natural and Xcel agree to a resale condition inconsistent with the 2006 Declaratory Order and the December 2010 Order. Northern Natural must therefore resell this capacity pursuant to its existing rates and terms and conditions of service and cannot contract to resell the capacity at market-based rates.²³

23. In the December 2010 Order, the Commission outlined an approach that Northern Natural might be able to use to resell capacity if a contract is terminated early. The Commission has not precluded Northern Natural from charging the value of the capacity up to the price received under the initial contract involved if the market permits.

24. Northern Natural also protests the Commission’s statement that the reserve price for any auction of turned-back capacity should be the just and reasonable rate on file for storage. The Commission set the reserve price at the just and reasonable rate on file for storage capacity to ensure that Northern Natural does not withhold capacity at what would be a just and reasonable rate. Because market-based rates do not apply to such resales, the Commission’s regulations require that the capacity be offered at the rate on file so that capacity is not withheld. If through the auction, shippers bid higher than the rate on file, then the higher rate would be due to the workings of a competitive market, not the exercise of market power.²⁴

25. Finally, Northern Natural asserts the Commission erred in terminating the technical conference. This has no merit since the purpose of technical conference was to

²² *Id.* P 9 n.4

²³ As noted *supra*, the only remaining avenue to support market-based rates would be a successful application pursuant to 18 C.F.R. § 284.502–.503 (2010).

²⁴ *Process Gas Consumers Group v. FERC*, 292 F.3d 831, 837 (D.C. Cir. 2002) (“as FERC argues, the fact that shippers may at times bid up contract length likely reflects not an exercise of Tennessee’s market power, but rather competition for scarce capacity”).

explore means for extending the section 4(f) market-based rates Northern Natural was authorized to use for the initial Redfield expansion contracts. Since the December 2010 Order determined this was not possible under the statutory and regulatory limitations applicable to section 4(f) market-based rates, the technical conference was properly terminated and rehearing is denied.

The Commission orders:

Northern Natural's requests for rehearing are denied for the reasons stated in the body of this order.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.