UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, Joseph T. Kelliher,
and Suedeen G. Kelly.

Northern Natural Gas Company Docket No. RP03-398-001

ORDER ON REHEARING

(Issued December 30, 2004)

1. Northern Natural Gas Company (Northern) and the Northern Municipal Distributors Group (NMDG)[1] with the Midwest Region Gas Task Force Association (MRGTF) [2] (jointly, NMDG/MRGTF) filed requests for rehearing of the Commission's May 30, 2003 Order [3] addressing Northern's section 4 rate case filing in the above-captioned docket, in which Northern proposed increased rates and numerous revisions to its terms and conditions of service. For the reasons set forth below, we will grant in part and deny in part the requests for rehearing.

[1] NMDG is composed of the following Iowa municipal-distributor customers of Northern Natural: Cascade, Cedar Falls; Coon Rapids; Emmetsburg; Gilmore City; Graettinger; Guthrie Center; Harlan; Hawarden; Lake Park; Manilla; Manning; Osage; Preston; Remsen; Rock Rapids; Rolfe; Sabula; Sac City; Sanborn; Sioux Center; Tipton; Waukee; West Bend; Whittemore; and Woodbine.

[2] MRGTF is composed of the following municipal-distributor and local distribution customers of Northern Natural: Austin; Circle Pines; Community Utility Company; City of Duluth, Minnesota – Duluth Public Utilities; Great Plains Natural Gas Company; Hibbing; Hutchinson; Midwest Natural Gas, Inc.; New Ulm; Northwest Natural Gas Company; Owatonna; Round Lake; Sheehan's Gas Company, Inc.; Two Harbors; Virginia; and Westbrook, Minnesota; Superior Waster Light & Power; St. Croix Valley Natural Gas, Wisconsin; Watertown, South Dakota; and Penninsular Gas Company, Michigan.

[3] *Northern Natural Gas Co.*, 103 FERC ¶ 61,266 (2003).

## I. Background

2. On May 1, 2003, Northern filed a general rate case pursuant to section 4 of the Natural Gas Act. Northern's filing consisted of a Primary Case and a Prospective Case. Northern proposed to implement the Primary Case, containing the rate increases and certain changes to the terms and conditions of service, on June 1, 2003. It proposed to implement the Prospective Case, containing additional rate provisions and changes to the terms and conditions of service, following a Commission order approving a settlement or following a hearing. The Commission, in its May 30, 2003 Order, accepted and suspended Northern's proposed tariff sheets to be effective, subject to refund, on November 1, 2003 after a five-month suspension period. The Commission also directed its staff to convene a technical conference [4] to discuss certain of Northern's proposed changes to its terms and conditions of service and established a hearing proceeding to address all other issues.[5]

3. Only the proposals made in the Primary Case are the subject of the requests for rehearing in this docket. Northern seeks rehearing of the Commission's rejection of its proposal to revise its Right of First Refusal (ROFR) tariff provisions to make the ROFR inapplicable to interim service agreements for capacity that is already under contract for a future period. In its request for rehearing, NMDG/MRGTF argues that the Commission should have rejected Northern's proposal to eliminate the annual redetermination of its Rate Schedules TF12 Base and TF12 Variable entitlements instead of setting the issue for hearing. NMDG/MRGTF also requests the Commission to reconsider the decision to set Northern's proposed imbalance provisions for discussion at the technical conference rather than for hearing.

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[4] The technical conference was convened on July 29, and 30, 2003 and the Commission issued an order following the conference on October 31, 2003. *Northern Natural Gas Co.*, 105 FERC ¶ 61,172 (2003); *order on reh'g*, 107 FERC ¶ 61,252 (2004).

[5] Northern filed another general section 4 rate case on January 30, 2004 in Docket No. RP04-155-000. The evidentiary hearing established in that docket was consolidated with the ongoing proceeding in the instant docket. 106 FERC ¶ 61,195 (2004).

## II. Discussion

### A. Right of First Refusal

### Proposed Tariff Changes and May 30, 2003 Order

4. Consistent with section 284.221(d) of the Commission's regulations,[6] section 52 of Northern's General Terms and Conditions of its FERC Gas Tariff provides Northern's shippers holding long-term firm agreements at maximum rates with a ROFR, and sets forth the procedures for exercising the ROFR. Section 52 further provides that the ROFR is not applicable to interim service agreements using capacity that Northern has reserved for potential use in connection with an expansion project.

5. In its May 1, 2003 rate case filing, Northern proposed to modify its ROFR provision in section 52 to make the ROFR also inapplicable to interim service agreements for entitlement associated with "capacity that is already under contract for a future period."[7] In other words, Northern proposed to eliminate the ROFR rights of an interim shipper acquiring capacity that is already under contract for a future period, even though the interim shipper would otherwise be eligible for a ROFR.

6. In its May 30, 2003 suspension order, the Commission rejected Northern's proposal to limit the ROFR rights of the interim shipper on the basis that it contravenes the Commission's policy set forth in Order No. 637 that the regulatory ROFR may not be narrowed, and is inconsistent with the Commission's decision in *Williams Gas Pipelines*

[6] 18 C.F.R. § 284.221(d) (2004). This regulation requires pipelines to provide firm maximum rate shippers holding contracts of one year or more a right of first refusal to renew their contracts and continue service. The ROFR protects gas customers from pipeline exercise of monopoly power by allowing captive customers served by a single pipeline to match competing bids and retain long-term firm transportation service. *See United Distribution Cos. V. FERC,* 88 F.3d 1105, 1140 (D.C. Cir. 1996).

[7] Proposed Fifth Revised Sheet No. 297 to Northern's General Terms and Conditions.

*Central, Inc.*[8] The Commission also expressed its concern about allowing a shipper to reserve capacity at a future date without requiring it to pay reservation charges once the transportation agreement is signed. The Commission stated this could tie up long-term capacity at the expense of other shippers who might value the capacity more.[9] However, the Commission explained that Northern could sell capacity at a future date, as long as the capacity was made available in the interim to other shippers on a long-term basis, with ROFR rights, and Northern was willing to expand its system to meet its contractual obligation to the future shipper at the time that shipper's contract commenced.

**Request for Rehearing**

7. Northern requests rehearing. It states that the proposed tariff revision is intended to meet the new market requirements of industrial end-users and power plants, which generally require 18-24 months of lead time for financing and constructing new projects. The Commission's rejection of its proposal, contends Northern, frustrates its attempt to efficiently meet this market need and leaves a shipper with two choices, neither of which, according to Northern, make economic or commercial business sense.

8. One option, explains Northern, would be for the power plant shipper to purchase the capacity in advance to secure the capacity for the future, begin incurring demand charges months before it needs the capacity, and release the capacity to another shipper in the interim under the Commission's capacity release regulations. First, Northern argues that a shipper should not be required to incur demand charges for service before it needs such service because it may ruin the economics of the project, potentially causing the power plant to not be built or forcing the shipper to use an alternate fuel. Second, Northern asserts that there is no guarantee that the future shipper will be able to release its capacity at maximum rates comparable to those paid during the interim period and thereby recoup its fixed costs. Northern contends that selling the released capacity may be impossible in times of low demand and that this possibility adds the risk of uncertain added costs to the future shipper's project.

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[8] *Williams Gas Pipelines Central, Inc.*, 97 FERC ¶ 61,249 (2001) (*Williams*). In *Williams*, the Commission rejected a contract provision requiring the shipper to waive or not exercise its ROFR. There, the Commission explained that narrowing the ROFR would limit a shipper's right to receive service and thereby provide a different quality of service accorded to other firm shippers under Williams' tariff.

[9] *Citing Transwestern Pipeline Co.*, 95 FERC ¶ 61,535 (2001).

9. Further, Northern states that if the shipper is able to release the capacity to the interim shipper, the interim shipper is not entitled to any ROFR rights that would interfere with the future shipper's use of the capacity. Therefore, argues Northern, a shipper acquiring capacity from the pipeline during an interim period also should not be entitled to a ROFR. Northern argues that it is unduly discriminatory that the shipper providing firm released capacity in the first instance is not required to provide ROFR rights, while Northern must provide such rights to the interim shipper in the second instance. It notes that the interim shipper purchasing released capacity from the future shipper is no worse off than if the interim capacity had been sold by Northern without ROFR rights.

10. The other option for a shipper, according to Northern, is to subscribe to capacity for a future period. However, Northern states that it must then offer the capacity in the interim to a shipper with a ROFR, if the interim service is for one year or more and the shipper pays the maximum rate. Under this scenario, Northern states the Commission has indicated that the pipeline must be prepared to build additional facilities to meet its contractual obligations to the future shipper in the event the interim shipper exercises its ROFR, even though the interim shipper may choose at the last moment not to exercise its ROFR. Northern argues that this is contrary to the Commission's policy of promoting the efficient and economic construction of capacity.

11. In contrast to the these options, Northern argues that its proposal is fair to both interim shippers and future shippers by providing each with the service it wants and needs, when its needs such service. It states that the interim shipper would know at the time it acquires the interim capacity that such capacity does not include ROFR rights. Northern argues that the Commission's capacity posting policies give the interim shipper the same opportunity to obtain the subject capacity on a long-term basis as any other shipper, so that if the interim shipper had wanted capacity for a longer term, it could have requested the capacity when it was previously posted as available for a longer term. To give the interim shipper a second chance to purchase long-term capacity that it previously declined, argues Northern, provides a preference for the interim shipper while penalizing the future shipper and pipeline.

12. Northern adds that the Commission's action is contrary to its policy in electric cases, where a transmission provider may limit ROFR rights for a contract obligation that begins in the future as long as the limitations are clearly stated in the customer's original service agreement.

13. Finally, Northern asserts that the ROFR proposal should have been set for discussion at the technical conference, rather than rejected, in order to review all the facts and consider how the proposal furthered the goals of maximizing the use of capacity, optimizing expansion planning and providing capacity to shippers who value it most.

**Commission Determination**

14. The Commission recently addressed a similar ROFR proposal in an order on remand in *Gas Transmission Northwest Corporation.*[10] In *GTN*, the Commission recognized that permitting pipelines to sell capacity for service to commence in the future has efficiency benefits and will benefit customers with long lead times who do not need capacity immediately, but need assurance that they can get capacity in the future. Accordingly, the Commission modified its policy and approved, subject to certain modifications and conditions, both a "prearranged deal," program proposed by the pipeline that would allow shippers to reserve available, unsubscribed capacity beginning at a future date, as well as the pipeline's related request to sell the same capacity to shippers in the interim without a ROFR.

15. While Northern's proposal in this proceeding also seeks to eliminate the ROFR for interim shippers purchasing capacity under contract for a future period, it is somewhat different than GTN's proposal, since, unlike GTN, Northern did not propose any tariff language expressly permitting it to engage in prearranged deals or any method for selling the capacity for the future period. Nevertheless, as discussed below, in light of the Commission's decision in *GTN*, the Commission will grant rehearing and permit Northern to sell capacity already under contract for a future period to interim shippers without a ROFR, subject, however, to conditions and requirements similar to those that the Commission has imposed on GTN's prearranged deal program and waiver of interim shippers' ROFR.

16. As background, prior to *GTN*, the Commission allowed waiver of the ROFR requirement only in the context of capacity reservation cases, where the Commission permits pipelines to reserve existing unsubscribed capacity for a temporary period so that the capacity can be included as part of a future expansion project.[11] The Commission has found that such "reservation of capacity will minimize facility construction and associated environmental impacts, will encourage fuller utilization of capacity, and will

[10] 109 FERC ¶ 61,141 (2004) (*GTN).*

[11] *See, e.g.*, *Iroquois Gas Transmission System*, 100 FERC ¶ 61,279 at P 5 (2002) (*Iroquois*).

minimize the rate impact of allocating costs of unsubscribed capacity to existing customers once the expansion is completed.”[12] The Commission has required pipelines to market the reserved capacity on an interim basis, *i.e.*, until it is needed on a more permanent basis by expansion shippers, and has waived its ROFR regulation for such capacity during the interim period, reasoning that interim shippers’ exercise of the ROFR would defeat the purpose of reserving the capacity.[13]

17. Further, under the capacity reservation program, there are several key safeguards that ensure that the pipeline is not reserving capacity to exercise market power. The pipeline must conduct a pre-reservation posting of the capacity to ensure that the capacity to be reserved is truly unsubscribed capacity that the pipeline has been unable to sell in its current configuration. The pipeline can reserve capacity only for one year before filing for a certificate, and thereafter until either the project goes into service, or the application is withdrawn or denied. In addition, the pipeline must conduct an open season for the expansion and give existing shippers an opportunity to turn back their capacity as an alternative to expansion or to minimize the size of expansion.

18. In the *GTN* proceeding, the pipeline proposed -- outside of the context of capacity reservations for expansion -- to sell either currently available, unsubscribed, capacity, or capacity expected to become available at some future date, to a shipper willing to execute an agreement for service to start at a specific date up to three years in the future in “prearranged deals." Under its proposal, GTN would post on its Internet website, one year prior to the commencement date of the prearranged deal, a notice that the capacity associated with the prearranged deal would be subject to GTN’s open season bidding process, and that the open bidding would commence no later than three months prior to the in-service date of the prearranged deal. If another party submitted a higher value bid, the prearranged shipper would have an opportunity to match that bid. In addition to posting all currently available capacity, GTN proposed separately identifying on its website all capacity anticipated to become available within the next 36 months.

19. In addition, GTN proposed that in the interim, it would offer shippers the opportunity to purchase the same capacity subject to the prearranged deal, but would deny the ROFR to interim shippers that secured capacity for more than 12 months. GTN argued that the Commission should waive the ROFR for these interim shippers because its prearranged deal program, in which shippers could reserve capacity for the future, was

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[12] *Northwest Pipeline Corp.*, 85 FERC ¶ 61,335 at 62,312 (1998).

[13] *Tennessee Gas Pipeline Co.*, 84 FERC ¶ 61,304 at 62,394-95 (1998), *order on reh’g*, 86 FERC ¶ 61,066 (1999).

analogous to the capacity reservation program, in which pipelines could reserve capacity for future expansions and under which the Commission had approved the waiver of the ROFR for interim sales of capacity.

20. The Commission approved GTN's prearranged deal program, with modifications,[14] but rejected GTN's request for a waiver that would allow it to deny a ROFR to interim shippers purchasing the capacity subject to the prearranged deal.[15]

21. On April 13, 2004, the United States Court of Appeals for the D.C. Circuit remanded for further consideration the Commission's denial of the waiver of the ROFR for interim shippers purchasing capacity under GTN's prearranged deal program.[16] The court found that the Commission had not provided a reasoned basis for distinguishing the capacity reservation cases, in which the waiver is granted, and the *GTN* proceeding, in which the waiver was denied. The court was persuaded that the prearranged deal program served the same goals as the capacity reservation cases, and sought what it concluded FERC had not supplied – a "compelling distinction between the two contexts." [17]

22. On November 3, 2004, the Commission issued its order on remand in *GTN*.[18] In *GTN*, the Commission no longer continued to advance a relevant distinction between GTN's prearranged deal program and the capacity reservation program, but, instead, acknowledged that permitting a pipeline to sell capacity for service to commence in the

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[14] Noting that GTN's tariff does not allow GTN to award capacity before the conclusion of the open season, the Commission directed GTN to clarify its tariff to provide that before it executes a service agreement under a prearranged deal for capacity becoming available in the future, it will post the availability of such capacity to afford potential shippers an equal opportunity to acquire the capacity.

[15] *PG&E Gas Transmission, Northwest Corp.*, 100 FERC ¶ 61,040 (2002) (accepting the initial proposal); *PG&E Gas Transmission, Northwest Corp.*, 102 FERC ¶ 61,044, *reh'g denied*, 103 FERC ¶ 61,061 (2003) (accepting in part and rejecting in part subsequent revisions to the initial proposal).

[16] *Gas Transmission Northwest Corp. v. FERC*, 363 F.3d 500 (D. C. Cir. 2004) (*GTN v. FERC*).

[17] *GTN v. FERC*, 363 F.3d at 503.

[18] 109 FERC ¶ 61,141 (2004).

future has efficiency benefits similar to those in the capacity reservation program, and will benefit customers with long lead times who do not presently need capacity, but need assurance that they can get capacity in the future. Therefore, the Commission ruled that it would permit GTN to enter prearranged deals with shippers for service to commence in the future, and, in particular, to sell capacity in the interim without a right of first refusal, but under a number of conditions similar in purpose and design to those applied in the capacity reservation context. Essentially, as described below, the Commission required a different bidding process than that proposed by GTN.

23. Under *GTN*, first, the Commission required the pipeline to post the prearranged deal as part of an open season bidding process as soon as the prearranged deal is entered into (but before capacity is actually awarded or reserved by an executed service agreement), to permit other parties an opportunity to bid on the capacity on a long-term basis with a ROFR, rather than waiting until one year before the service commencement date to post the prearranged deal and only three months before the in-service date to begin open bidding, as GTN had proposed.[19] This open season bidding process is to take place even if capacity already has been subject to an open season and currently is posted as available. Any third party wishing to purchase the capacity, whether for service commencing immediately or in the future, could then participate in the open season. The Commission imposed this immediate bidding requirement to mirror what occurs in the capacity reservation context, where the Commission requires the pipeline to conduct a pre-reservation posting for the capacity indicating that the pipeline intends to reserve the capacity and giving anyone who wants the capacity in the pipeline's current configuration an opportunity to buy it.[20] The Commission also explained that requiring the bidding process to occur as soon as a prearranged deal is formulated will give shippers enforceable contractual rights to capacity at a specific price early on, rather than a mere opportunity to match a competing bid, which prearranged deal shippers would have under GTN's proposal delaying the posting and bidding process up to three months before the commencement of service.[21]

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[19] *Id*. at P 15.

[20] *Northern Natural Gas Co.*, 105 FERC ¶ 61,057 at P 13 (2003), *reh'g denied*, 107 61,072 (2004).

[21] 109 FERC ¶ 61,141 at P 18.

24. Second, the Commission required the pipeline in *GTN* to evaluate the bids on a net present value basis, since GTN employs a net present value pricing method in its tariff provisions governing the allocation of capacity.[22] The Commission explained that in calculating net present value, the current value of the future bid would be reduced by the time value of the delay in the pipeline receiving that revenue.[23] If a competing bid for service to commence immediately, or in the future, provides a higher net present value than the prearranged deal, the pipeline would give the prearranged shipper a one-time right to match the bid. This bidding process is designed to ensure that at the time of the request for prearranged capacity, there is no other shipper wishing to purchase the capacity either immediately or in the future that would place a higher value on the capacity. Once future capacity is awarded to the shipper that places the highest value on the capacity, then any interim long-term capacity could be available without a ROFR, without concerns of preferential treatment and the exercise of market power by the pipeline.

25. As noted above, in this proceeding, Northern seeks to eliminate the ROFR for interim shippers purchasing capacity that is "already under contract for a future period," but does not propose a method or procedure for selling capacity for a future period, such as the prearranged deal program prescribed in *GTN*. Nor do Northern's existing tariff provisions for the allocation of capacity include any provisions governing the sale of capacity for future periods. Included in section 26 of Northern's General Terms and Conditions, "Requests for Throughput Service," are provisions for Northern's posting and awarding of available capacity. Section 26 requires Northern to post weekly its available capacity on its website, but does not require Northern to solicit bids on its available capacity.[24] Thus, under its tariff, Northern may enter into contracts for capacity for the future at its discretion, and need not subject such contracts to a bidding process. Further, if Northern does post a notice for solicitation of bids for particular segments of capacity, it may or may not include a bid evaluation methodology. If a bid evaluation

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[22] *Id*. at P 17.

[23] For example, a 20-year contract at maximum rate, starting two years from today, might have less value than a 10-year maximum rate bid submitted today.

[24] The tariff provides only that "Northern shall have the right to post notices for solicitation of bids for particular segments of capacity." Eighth Revised Sheet No. 252 of Northern's Fifth Revised Volume No. 1 of its FERC Gas Tariff.

methodology is included, it could be a method other than highest total net present value; however, if no specific bid evaluation methodology is posted, then the default methodology for the best bid is the highest total net present value.[25]

26. Consistent with the Commission's new policy articulated in *GTN* to permit the sale of capacity subject to a prearranged deal for service to commence in the future to interim shippers without a ROFR, the Commission will grant rehearing in this case and allow Northern to sell capacity already under contract for a future period to interim shippers without a ROFR by imposing posting and bidding requirements on Northern's sale of capacity for future periods similar to those required in *GTN*. Specifically, the Commission will permit Northern to sell capacity to interim shippers without a ROFR as long as Northern implements posting and bidding procedures that will ensure that the shipper obtaining the capacity for the future period is the shipper that places the highest net present value on the capacity. Northern must revise its tariff provisions in a manner that will accomplish this.

27. There are two basic ways in which Northern may revise its tariff consistent with the above discussion. First, Northern may wish to follow the pipeline's approach in *GTN* and develop some form of "prearranged deal" program. Under this approach, Northern could individually negotiate contracts with shippers for service to start at some time in the future. Northern would then be required to immediately post such prearranged deal for open season bidding to allow other parties an opportunity to purchase the capacity, either for service to commence immediately or in the future. Northern would evaluate all bids received on a net present value basis. In calculating net present value, the current value of the future bid would be reduced by the time value of the delay in the pipeline

[25] Section 26 states, in part, "Such notice [for solicitation of bids] may include a bid evaluation methodology, in which case the posting will be made at least three (3) days prior to bidding. In addition, Northern will post whether bids have been received and show the full net present value (NPV) analysis for the highest bid received, the shippers' bids, and provide the actual calculation of the NPV with sufficient clarity to permit bidders to duplicate the results. In the event Northern receives bids for new capacity, the capacity will be allocated to the best bid. In the event a specific bid evaluation methodology has not been posted, the default methodology for the best bid will be the bid with the highest total NPV. The NPV is the discounted cash flow of incremental revenues to Northern for service. . . . If an alternate bid evaluation methodology is used, Northern will post the evaluation factors to be utilized along with each factor's weight." Eighth Revised Sheet No. 252 of Northern's Fifth Revised Volume No. 1 of its FERC Gas Tariff.

receiving that revenue.[26] If a competing bid for service to commence immediately, or in the future, provided a higher net present value than the prearranged deal, Northern would give the prearranged shipper a one-time right to match the bid. If matched, the prearranged shipper would obtain the capacity; otherwise, Northern would award the capacity to the other shipper since its bid would have the highest NPV. Once future capacity is awarded, Northern could then sell any interim long-term capacity without a right of first refusal.

28. Second, Northern may instead simply formulate an open season bidding process for available capacity whereby Northern would hold an initial open season permitting bids for capacity for service to start immediately or anytime in the future. Again, all bids would be evaluated on a net present value basis, and Northern would award capacity to the shipper providing the highest net present value bid. If the winning bid is for service to start in the future, Northern could then choose to sell capacity to shippers in the interim without a ROFR.

29. As the Commission explained in *GTN*, the posting and bidding process outlined above seeks to ensure that at the time of the request for prearranged capacity, or sale of capacity for a future period, there is no other shipper wishing to purchase the capacity either immediately or in the future that would place a higher value on the capacity.[27] This is the same goal the pre-reservation posting requirement in the pipeline capacity reservation context seeks to achieve. Therefore, by ensuring that the capacity is awarded to the party willing to pay the highest net present value for it, this approach allows a more efficient allocation of capacity. It will prevent Northern from giving preferential treatment to a customer that wishes to secure capacity for the future or enter a prearranged deal, by first subjecting the deal to a bidding process. Since Northern's request to waive the ROFR for interim shippers did not address Northern's ability to sell capacity for future periods and assumed Northern's ability to do so without restrictions, the above conditions ensure that Northern can only deny interim shippers a ROFR after awarding the future capacity to a shipper that values it most. And it gives a generation developer the opportunity to secure capacity in advance, without the risk that it will later have to match a competing bid for the capacity during a subsequent bidding process.

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[26] As indicated, *supra*, Northern's tariff already provides for the use of a net present value bid evaluation methodology and contains detailed language explaining the calculation of the net present value; however, here, the Commission is making its use mandatory for purposes of selling capacity for a future period.

[27] 109 FERC ¶ 61,141 at P 18.

30. Finally, as Northern points out, under the Commission's policy in electric transmission cases, a transmission provider may limit the ROFR or rollover rights of an interim customer due to native load growth requirements or a preexisting contract obligation that commences in the future, as long as those obligations and the lack of rollover rights are clearly set forth in the service agreement of the interim customer.[28] Permitting Northern to sell capacity to interim shippers without a ROFR under the above conditions gives natural gas shippers a similar right to reserve future capacity and displace the interim shipper's ROFR that is available to electric transmission customers, and thereby more closely aligns the Commission's policy on the waiver of the ROFR in the natural gas pipeline and electric transmission contexts.

### B. <u>TF12 Base and Variable Daily Entitlement Levels</u>

31. In its rate filing, as part of its Primary Case to take effect on June 1, 2003, Northern proposed to eliminate its annual redetermination of TF12 Base and TF12 Variable daily entitlement levels and to establish a new method for determining these levels for contracts entered into after June 1, 2003. The proposal would "freeze" the current TF12 Base and Variable entitlement levels when, in the past, these levels were changed annually based on a shipper's throughput for the previous summer period. In its May 30, 2003 Order, the Commission set the issue for hearing, which would allow the proposal to take effect, subject to refund, on November 1, 2003. Northern has not filed to move the suspended tariff sheets into effect.

#### <u>Request for Rehearing</u>

32. NMDG/MRGTF requests that the Commission grant rehearing and summarily reject Northern's proposal because it argues the proposal violates the terms of a settlement approved by the Commission in Northern's previous base rate proceeding in Docket Nos. RP98-203-000, *et al.*[29] NMDG/MRGTF states that the settlement provides that Northern will not implement rate design changes prior to the filing of its next general section 4 rate case and that any such proposed modifications in such rate case will be proposed for prospective implementation only pursuant to a Commission order on the

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[28] *See, e.g., Southern Company Services, Inc.*, 102 FERC ¶ 61,200 at P 15 (2003); *Constellation Power Source, Inc. v. American Electric Power Service Corp.*, 102 FERC ¶ 61,142 at P 23 (2003).

[29] *See Northern Natural Gas Co.*, 87 FERC ¶ 61,321 (1999).

merits or a settlement.[30] NMDG/MRGTF argues that Northern's proposal to change the calculation of the TF12 Base and TF12 Variable entitlement levels is a rate design change that is not proposed for prospective implementation and, as such, is prohibited by the settlement. NMDG/MRGTF asserts that, while Northern has claimed that it is only a change in the calculation of contract entitlement, the annual redetermination of entitlement levels is part and parcel of the rate design of Northern's TF service.

33. NMDG/MRGTF further argues that Northern's proposal should also be rejected on substantive grounds. It submits that Northern failed to provide any testimony as to why or how it is fair to shippers to freeze current levels without warning, or any testimony showing that current levels are representative of the levels of TF12 Base and Variable entitlement that each of its shippers could be expected to have on an average annual basis. NMDG/MRGTF also refutes Northern's arguments that the current redetermination process is administratively burdensome since it maintains the process can be easily computerized.

**<u>Commission Determination</u>**

34. The Commission will deny rehearing. The Commission did not err by exercising its discretion to set Northern's proposal to change the calculation of TF12 Base and TF12 Variable daily entitlement levels for hearing, rather than summarily rejecting the proposal. The issue of the applicability of the settlement to Northern's proposal, that is, specifically, whether Northern's proposed change constitutes a rate design change within the meaning of the settlement, is properly included in the ongoing hearing in this case. Parties are free to argue their respective positions in the hearing. Therefore, the Commission clarifies that the issue to be addressed in the hearing is not only whether the proposed change on its merits is just and reasonable, but also what would be the appropriate effective date for the change consistent with the settlement, assuming the proposal is just and reasonable. The Commission notes that Northern has not yet filed to

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[30] *See* Article IV.B (Future Changes) of Northern's April 16, 1999 Stipulation and Agreement at 18.

move the suspended tariff sheets into effect, so it is possible that Northern's proposed change, if found just and reasonable, ultimately will be implemented prospectively, consistent with the settlement.[31]

### C. Imbalance Provisions

35. As part of its section 4 rate filing, Northern proposed changes to its imbalance mechanism. Specifically, it proposed to: (1) value its cash-out imbalances based on an average weekly high/low index price; (2) reduce its cash-out tolerance level from three percent to two percent; and (3) add a new tier for imbalances greater than 25 percent. In its May 30, 2004, Order, the Commission set these proposals for technical conference. In its October 31, 2004 Order following the technical conference, the Commission accepted Northern's proposal to implement a weekly high/low cash-out mechanism, and rejected Northern's proposal to add a new tier for imbalances greater than 25 percent.[32]

36. NMDG/MRGTF argues that the Commission erred in setting Northern's imbalance proposals for technical conference. NMDG/MRGTF contends the Commission should have set the proposals for hearing, where parties have full discovery and testimony rights, and the proposals would only become effective after a Commission order on the merits or a settlement. NMDG/MRGTF believes a technical conference is inappropriate, given the magnitude and fact-dependency of these issues. NMDG/MRGTF recommends that the Commission direct Northern to designate its imbalance mechanism proposal as *pro forma* tariff change so it will only take effect prospectively.

37. The Commission denies NMDG/MRGTF's rehearing request. First, NMDG/MRGTF's request, for the most part, is moot, since a decision on Northern's imbalance proposals has already been rendered in the technical conference proceeding. Second, it is within the Commission's discretion to decide whether the best vehicle for addressing a particular proposed tariff change is a technical conference or a hearing. In a general section 4 rate proceeding, the Commission typically sets the proposed changes in

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[31] On October 27, 2003, Northern filed to move certain of the suspended tariff sheets info effect, but not those sheets containing changes to the calculation of the TF12 Base and Variable daily entitlement levels. The filing was accepted in an unpublished Director letter order dated November 25, 2003.

[32] 105 FERC ¶ 61,172 (2003). In its September 30, 2003 reply comments, Northern had withdrawn its proposal to reduce its existing imbalance tolerance level from three percent to two percent.

rates for hearing. Pipelines, though, sometimes include as part of their section 4 rate filing, proposed changes to general terms and conditions of service. In those cases, the Commission will typically make merit-based decisions on the revised terms and conditions instead of setting them for hearing. This allows the Commission to review the merits of the proposed terms and conditions of service before they take effect at the end of the suspension period. In the instant case, Northern's proposed changes to its imbalance mechanism constitute changes to its general terms and conditions of service. Accordingly, the Commission, instead of setting the proposals for hearing, convened a technical conference and made a merits ruling on the proposal prior to the close of the suspension period.[33]

The Commission orders:

(A) The requests for rehearing of the Commission's May 30, 2003 Order in this proceeding are granted in part, and denied in part, subject to the conditions specified in this order.

(B) Northern is directed to submit revised tariff sheets consistent with the Commission's discussion in the body of this order within 30 days of the date of this order.

By the Commission.

( S E A L )

Linda Mitry,
Deputy Secretary.

[33] *Northern Natural Gas Co.*, 105 FERC ¶ 61,172 (2003), *order on reh'g*, 107 FERC ¶ 61,252 (2004).