111 FERC ¶ 61,379
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. RP05-181-001

ORDER ON REHEARING

(Issued June 8, 2005)

1. On April 22, 2005, Cornerstone Energy, Inc. (Cornerstone) and the Northern Municipal Distributors Group and the Midwest Region Gas Task Force Association (Distributors) filed requests for rehearing of the March 23, 2005 Order in the captioned docket.[1] The March 23, 2005 Order accepted several negotiated rate agreements, subject to certain conditions, between Northern and CenterPoint Energy Minnesota Gas (CenterPoint). These agreements contained several non-conforming provisions filed by Northern including: (1) a growth option allowing CenterPoint to increase its Maximum Daily Quantity (MDQ) at certain intervals and at pre-determined rates; (2) a commitment by CenterPoint to take its full service requirements from Northern, and; (3) a provision whereby CenterPoint agreed not to bypass Northern in its existing service territories.

2. As discussed below, the Commission denies the requests for rehearing of the March 23, 2005 Order.

I. Background

3. On February 11, 2005, Northern filed several non-conforming service agreements and a letter agreement comprising a service transaction it proposed to enter into with CenterPoint. These agreements included: (1) a maximum rate TF service agreement; (2) a discounted rate TFX service agreement;[2] (3) a discounted rate TFX backhaul

[1] *Northern Natural Gas Co.*, 110 FERC ¶ 61, 321 (2005) (March 23, 2005 Order).

[2] Northern's Rate Schedule TF provides a firm transportation service with a uniform year-round rate. Rate Schedule TFX provides a firm transportation service with a higher rate in winter (November-March) than summer (April-October).

agreement (Trailblazer agreement), and; (4) a letter agreement. Northern stated that the proposed agreements related to service commencing November 1, 2007, when Northern's current contracts with CenterPoint expire.

4. In its February 11, 2005 Filing, Northern asserted that CenterPoint had issued a Request for Proposal to construct an intrastate pipeline to serve CenterPoint's Minneapolis market and bypass Northern beginning November 1, 2007, when its current contracts with Northern expire. Northern asserted that CenterPoint received seven responses to its request and had finalized negotiations with one bidder to build its intrastate pipeline before Northern commenced negotiations with CenterPoint. Northern stated that CenterPoint is its largest customer, and that the loss of the CenterPoint load would result in a 10 to 15 percent rate increase for its remaining customers based on maximum rates in a future rate case.

5. Northern stated in its February 11, 2005 Filing that it was able to negotiate with CenterPoint a new long-term agreement with CenterPoint so as to avoid the loss of CenterPoint as a customer and that the filing contained certain non-conforming provisions that were necessary to accomplish this agreement. Northern stated that the non-conforming provisions in one or more of the proposed agreements include: (1) a growth option allowing CenterPoint to increase its MDQ at certain intervals over the contract term, at specific levels, and at pre-determined rates; (2) a commitment by CenterPoint to take its full service requirements from Northern; (3) a provision whereby CenterPoint agrees not to bypass Northern in its existing service territories; (4) a renegotiation provision should the Commission not approve the subject provisions; (5) a provision obligating CenterPoint to support the agreed-to transportation rates; (6) revised TF12/TF5 entitlements;[3] (7) a provision requiring Northern to grant a Most Favored Nation (MFN) provision to CenterPoint should it grant one to another shipper; (8) a provision requiring Northern to exercise commercially reasonable best efforts to secure any approvals required for the construction of new facilities under the agreements, and; (9) a provision clarifying that the three subject service agreements and letter agreement constitute the entire agreement between the parties. In addition, Northern's letter agreement also required Northern to pay between $250,000 and $300,000 annually to CenterPoint to promote load growth.

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[3] Pursuant to Northern's Rate Schedule TFX, TF12 refers to firm transportation service for 12 months of the year. TF5 refers to the additional firm transportation under Rate Schedule TFX for the five winter months.

6. The Commission found that Northern's proposed service agreements contained several non-conforming, material deviations from Northern's tariff or *pro forma* service agreements that were sufficiently connected to the proposed rates so as to not present a substantial risk of undue discrimination or a substantial negative impact upon other shippers and do not affect the quality of service provided. The Commission, therefore, accepted those provisions without condition. However, the Commission found that several other non-conforming provisions not so closely connected to the proposed rates might pose a risk of undue discrimination and therefore required further discussion. These provisions included the proposed growth option, bypass, and full service requirement provisions, as well as provisions contemplating a load growth promotion payment and MFN treatment for CenterPoint.

7. The Commission found that the interrelated growth option, bypass, and full service requirement provisions were comprised of impermissible terms and conditions of service and that Northern's FT and FTX Rate Schedules did not provide for such services. Accordingly, the Commission found that Northern could not include these provisions as non-conforming provisions to its agreements with CenterPoint because these interrelated provisions provide a substantial risk of undue discrimination. However, the Commission stated that if Northern desires to provide a full requirements service as proposed, it must mitigate the risk of undue discrimination among its customers by filing to place such a service into its tariff so that it would be generally available to all customers. The Commission also determined that the MFN clause and the load growth promotion payment provision were acceptable for inclusion in Northern's agreements.

8. In addition, the Commission determined that its approval of the subject agreements did not represent a determination that the Commission will allow Northern to recover these discounts in any future rate proceeding and specifically stated that "in any future rate case that Northern may file, it must justify its case for any recovery of discounts, and the Commission will make its determination in that proceeding."[4]

II. Discussion

A. Discount Rate

9. For the reasons discussed below, the Commission denies rehearing. Cornerstone and Distributors both contend that the Commission should not have approved the discounted rates included in the Rate Schedule TFX agreements, as well as a potential

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[4] 110 FERC ¶ 61,321 at P 32.

discount in the Rate Schedule TF agreement without further investigation of various issues. Cornerstone argues that the CenterPoint discounts will have an adverse effect on retail competition behind CenterPoint's citygate because it is unlikely that an alternative gas supplier can compete successfully against CenterPoint given CenterPoint's discounted rates. Cornerstone argues that, given these anti-competitive effects of the discount provided CenterPoint, the Commission should have further investigated the need for the discounts to retain CenterPoint as a customer, including the bona fide nature of the alleged threat of bypass and the reasonableness of Northern's response to this threat. CenterPoint also asserts that the discounts given to CenterPoint are likely to have altered the perspective of CenterPoint and Northern with respect to the contested issues raised and proposed to be resolve in Northern's pending Natural Gas Act (NGA) section 4 rate case settlement in Docket No. RP03-398-000, *et al*., and that the impact of this transaction on other shippers should be closely examined by the Commission.

10. Cornerstone argues that these are not issues that can be deferred until a later date. Cornerstone states that in *MPC*, the court found that the Commission had failed to consider the anticompetitive implications of its pre-Order No. 436 blanket certificate transportation program.[5] Cornerstone states that the Commission program examined in *MPC* had made pipeline transportation available only to non-captive shippers on the grounds that the loss of those customers would impose greater burdens on captive shippers, much the same as the arguments presented by Northern in the instant case. Cornerstone argues that the court in *MPC* emphasized both the Commission's need to undertake a competitive analysis and its obligation to do so sooner, rather than later.

11. Accordingly, Cornerstone argues that given the immediate competitive harm that these transactions would cause as well as the difficulty and potential unfairness to CenterPoint of unraveling them at a later time, the Commission should determine now, in this proceeding, whether the discounts at issue are competitively justifiable and would result in just and reasonable rates for all shippers on Northern's system.

12. Section 284.10(b)(5)(ii)(A) of the Commission's regulations expressly permits a pipeline to "charge an individual customer any rate that is neither greater than the maximum rate nor less than the minimum rate on file for that service." Consistent with that regulation, Northern's tariff sets forth both a maximum just and reasonable rate and a minimum rate for each service. Thus, the discounted rates Northern has agreed to provide CenterPoint are not deviations from Northern's tariff that require Commission approval. Rather, the Commission has already authorized those discounts through its Part

[5] Cornerstone Request for Rehearing at 11, *citing*, *Maryland People's Counsel v. FERC*, 761 F.2d 780 (D.C. Cir. 1985) (*MPC*).

284 regulations and its approval of Northern's tariff. The only aspects of Northern's contracts with CenterPoint requiring approval in this proceeding are the material deviations from Northern's form of service agreement such as the full requirements, load growth, and bypass provisions.

13. Cornerstone suggests that, despite the fact the discounted rates Northern has provided CenterPoint are authorized by Northern's tariff, the Commission should nevertheless refuse to permit Northern to provide those discounts, since those discounts would give CenterPoint a competitive advantage over Cornerstone in the downstream markets in which Cornerstone allegedly competes with CenterPoint. However, since Order No. 436, the Commission has consistently permitted pipelines to offer selective discounts to shippers based on their varying elasticities of demand, and the Commission has recently reaffirmed that policy based on comments received in response to the Notice of Inquiry issued in Docket No. RM05-2-000.[6] The Commission has found that permitting such discounts benefits captive customers by increasing throughput and thereby obtaining a contribution to fixed costs from demand elastic customers that otherwise would not be obtained at all,[7] and the court has affirmed the Commission's policy in this regard.[8]

14. The Commission does not believe that Cornerstone's vague assertion that CenterPoint's discount could give it a competitive advantage over Cornerstone in a downstream market where they compete is sufficient reason to disapprove a discount that is consistent with Commission policy. Cornerstone has provided no explanation of the

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[6] *Policy for Selective Discounting by Natural Gas Pipelines*, 109 FERC ¶ 61,202 (2004).

[7] Order No. 637-A, ¶ 31,099 at 31,551-52 ("The justification for permitting this exercise of market power is to enhance efficiency by increasing throughput and to benefit those captive customers with long-term contracts by reducing, in the next rate case, the amount of fixed costs that otherwise would be recovered through the rates paid by those captive customers"), 1A. Kahn, the Economics of Regulation 131-33 (1970) (price discrimination one solution to problems of natural monopoly and declining costs).

[8] *Associated Gas Distributors v. FERC*, 824 F.2d 981, 1010-12 (D.C. Cir. 1987) (*AGD*) (selective discounting permitted to benefit captive customers by contributing to payment of fixed costs), *cert. denied*, 485 U.S. 1006 (1988); *United Distribution Companies v. FE*RC, 88 F.3d 1105, 1141-42 (D.C. Cir. 1996) (affirming the Commission's determination to permit selective discounting and not requiring pipelines to discount).

markets in which it competes with CenterPoint, how it transports gas to those markets, or what its transportation costs are. If Cornerstone believes that it is similarly situated to CenterPoint because, for example, it has a similar elasticity of demand, it may file a complaint against Northern if Northern refuses to grant it a similar discount. Such a complaint proceeding would provide an opportunity to develop a record concerning the extent to which Cornerstone is similarly situated to CenterPoint so as to justify a similar discount.

15. Cornerstone's reliance on *MPC* is misplaced. In that case, the court addressed a situation where the Commission allowed pipelines to deny captive customers access to the spot market for the gas commodity, while providing such access to non-captive customers. The court found that the Commission had erred by failing to consider the anticompetitive consequences of its action and vacated and remanded the Commission's orders insofar as they permitted pipelines to provide transportation service to fuel-switchable end users without requiring pipelines to provide the same service to LDCs and captive customers on non-discriminatory terms.[9] However the instant case does not involve a situation where the Commission is permitting a pipeline to deny a service to some customers while providing the same service to other customers. In fact, the Commission has required that Northern offer the same type of service it has agreed to provide CenterPoint to all its other customers. The Commission is only permitting Northern to offer different rates to different customers depending upon their different elasticities of demand. In *AGD*, the court held that to read *MPC* as "a rule that price differentials based on demand conditions are always unduly discriminatory would render the decision a defiant and unreasoned exception to the general pattern. The judicial acceptance of such price differentials is longstanding."[10]

16. Distributors contend that the Commission should decide now whether it will permit Northern in its next rate case to reduce its rate design volumes to account for the discounts associated with the subject service agreements should not be deferred to a future rate case. Distributors assert that it will be required to produce evidence in a future rate case that the discounts provided to CenterPoint were not justified by competition. Distributors state that Northern believes that it has a right to recover the discounts at issue here and that the discounts have benefits to other customers. Distributors argue that Northern has failed to prove these benefits here and that the Commission must demand such proof in the instant proceeding.

[9] *MPC,* 761 F.2d at 789.

[10] *AGD*, 824 F.3d at 1011 (footnotes omitted).

17. In the 1989 Rate Design Policy Statement,[11] the Commission sought to adopt a rate design methodology that would prevent the subsidization of the discounts by non-discounted customers and, at the same time, maximize throughput. On rehearing, the Commission rejected contentions that the clarification in the Policy Statement would lead to non-discounted customers subsidizing the discounted customers and stated that its selective discounting policy "allows a pipeline to maximize throughput by lowering prices to retain and attract business by meeting competition."[12] The Commission also stated that while the pipeline was at risk for service provided at prices below those projected in the setting of its rates, if a pipeline grants a discount in order to meet competition, the pipeline may, in its next rate case, design its rates using reduced discounted volumes instead of assuming that the discounted volumes would flow at the maximum rate, so that the pipeline will be able to recover its cost of service.

18. Moreover, in its recent NOI,[13] the Commission outlined the manner in which discounting cases were to proceed. In the NOI, the Commission stated:

> In order to obtain such a discount adjustment in a rate case, *the pipeline has the ultimate burden of showing that its discounts were required to meet competition*. . . . In the case of discounts to non-affiliated shippers, the Commission has stated that it is a reasonable presumption that a pipeline will always seek the highest possible rate from such shippers, since it is in the pipeline's own economic interest to do so. Therefore, once the pipeline has explained generally that it gives discounts to non-affiliates to meet competition, parties opposing the discount adjustment have the burden of producing evidence that discounts to non-affiliates were not justified by competition. *To the extent those parties raise reasonable questions concerning whether competition required the discounts given in particular non-affiliate transactions, then the burden shifts back to the pipeline to show that the questioned discounts were in fact required by competition*.[14]

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[11] 47 FERC ¶ 61,295, *order on reh'g*, 48 FERC ¶ 61,122 (1989).

[12] 48 FERC at p. 61,449 (footnote omitted).

[13] *Policy For Selective Discounting By Natural Gas Pipelines,* Docket Nos. RM05-2-000 and RM97-7-000, 109 FERC ¶ 61,202 (2005).

[14] *Id.* at P 7 (emphasis added).

19. On May 31, 2005, the Commission reaffirmed its discount policy and terminated the rulemaking proceeding initiated by the NOI.[15] The Commission explicitly reaffirmed its burden of proof requirement for discount adjustments as set forth in the NOI and stated that a hearing in a rate case gives all parties an opportunity to seek discovery regarding the purpose and level of any discount.[16] These procedures give Distributors a full opportunity to contest any discount adjustment Northern may seek in its next rate case with respect to the CenterPoint discounts. Distributors will have an opportunity to seek discovery from Northern as to all the facts surrounding its offer of discounts to CenterPoint. Distributors will not have the burden of proving that the discounts were not offered to meet competition. Rather, Distributors will only have to produce evidence raising reasonable questions about whether competition required the discounts. Once such questions are raised, Northern will have the burden of showing that in fact competition did require the discounts.[17]

20. Distributors point out that Northern claimed that the loss of the CenterPoint load would result in a 10 to 15 percent rate increase for its customers and that the Commission apparently accepted this claim because it states in the March 23, 2005 Order that this approval "benefits the public by permitting Northern to retain its system load shippers and prevent[s] any cost shift to other customers caused by the loss of such load."[18] Distributors assert that the Commission cannot find that on one hand the issues concerning discounts and impact on rates are to be left to a future rate case and on the other hand state that the basic reason for approving the service agreements is that the public benefits from the approval because load is retained which prevents a cost shift to other customers. Distributors argue that the parties must be permitted to explore, *inter alia*, the factual basis for Northern's assertion that a 10 to 15 percent cost shift would occur and whether the impact of reflecting the discount and market payments in the rates paid is greater than or equal to the cost shift that was allegedly prevented. Distributors argue that the Commission should reverse its acceptance of the service agreements and reject the agreements or condition its acceptance by requiring that Northern not seek to recover the cost of the discounts from customers in a future rate proceeding.

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[15] *Policy For Selective Discounting By Natural Gas Pipelines*, 111 FERC ¶ 61,309 (2005).

[16] *Id.* at P 62.

[17] *See also*, *Iroquois Gas Transmission L.P.*, 84 FERC ¶ 61,086 at 61,477 (1998).

[18] Distributors Request for Rehearing at 13, *citing*, *Northern Natural Gas Co.*, 110 FERC ¶ 61, 321 at P 2. (2005).

21. The quoted language from the introductory section of the March 23, 2005 order cited by Northern did not constitute a holding by the Commission concerning whether Northern would be permitted to recover the costs from its discounts in a future rate case. The Commission's finding on this matter in the discussion section of the order was clear. In that section, the Commission quoted its regulations and precedent and stated that, "Commission approval of the subject agreements does not represent a determination that the Commission will allow Northern to recover these discounts in any future rate proceeding."[19] Moreover, the Commission stated that Northern acknowledged the Commission's policies in this regard by stating, "Northern is not, however, here requesting any approval in regard to the rate impact, which will be dealt with in the normal course in a subsequent general rate proceeding" in its transmittal letter.[20] In conclusion, the Commission stated that "in any future rate case that Northern may file, it must justify its case for any recovery of discounts, and the Commission will make its determination in that proceeding."[21]

22. Northern asserted that the subject filing would allow it to retain load and prevent a cost shift to other customers. However, the Commission approved the filing based upon the fact that that Northern's proposal was, as conditioned, consistent with the Commission's discount policies and the Commission's negotiated rate policies. To the extent that the Commission's attempt in its introductory paragraphs to summarize the order in one sentence inappropriately led parties to misunderstand the Commission's basis for accepting Northern's filing, the Commission clarifies its previous order.

B. Full Requirements Tariff Provision

23. Cornerstone contends that the Commission should have simply rejected the interrelated growth option, bypass and full requirements provision in the CenterPoint contracts, rather than giving Northern the option of offering such provisions on a generic basis. Cornerstone argues that the Commission's review of the implications of the full requirements/load growth service afforded by Northern to CenterPoint was too narrow and that it failed to consider the broader competitive and other consequences of this form of service. Cornerstone argues that this proposed service is anticompetitive both from the standpoint of competitors to Northern and competitors of CenterPoint.

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[19] 110 FERC at P 32.

[20] *Id.*

[21] *Id.*

24. Cornerstone argues that the Commission's determination that the defects of a full requirements service could be cured by making that form of service generally available fails to comport with *DTI*,[22] and that this type of provision and the unfair capacity allocation associated with the load growth provision frustrates the efforts of competitive pipelines to provide alternatives to CenterPoint's retail services and in other regions where Centerpoint is able to compete in the wholesale or "grey" market for off-system sales. Cornerstone points out that the full requirements service further harms competitors of CenterPoint who will not likely be eligible for or interested in the full requirement/load growth service. Cornerstone argues that when presented with concerns such as the anticompetitive issues presented here the Commission must examine such issues to meet the requirements of reasoned decision making.

25. Cornerstone also argues that Northern's full requirements/load growth provisions are inconsistent with the Commission's findings in *El Paso*, where the Commission determined that a full requirements/load growth service established through settlement resulted in a substantial degradation of firm service, including capacity constraints and significant curtailment of firm service levels.[23]

26. Cornerstone states that while there may be factual differences between *El Paso* and the instant proceeding, the lack of any direct relationship between the rates CenterPoint would pay for incremental Rate Schedule TFX service and the costs of construction that may be necessary for Northern to support them echoes a key flaw found in *El Paso.* Cornerstone argues that that this lack of relationship between the costs incurred and the cost responsibility may provide an incentive for Northern to avoid incremental construction for which it would not be compensated as was the case in *El Paso*.

27. To the extent that Cornerstone argues that the full requirements provision itself is anticompetitive, the Commission finds that it is not anticompetitive to present a customer with a choice of purchasing a firm service if the customer has a viable alternative. Here, shippers on Northern's system may avail themselves of traditional firm or interruptible service or the full requirements service. For example, the Commission has previously

[22] Cornerstone Request for Rehearing at 20, *citing*, *Dominion Transmission, Inc.*, 94 FERC ¶ 61,057 (2001) (*DTI*).

[23] Cornerstone Request for Rehearing at 22, *citing*, *El Paso Natural Gas Co.*, 99 FERC ¶ 61,144 (2002*), order on reh'g*, 104 FERC ¶ 61,045 (2003)*, aff'd, Arizona Corp. Comm'n v. FERC*, 397 F.3d 952 (D.C. Cir. 2005) (*El Paso*).

found that firm service with its accompanying reservation charge would have a tendency to bind a customer to the pipeline but did not find the firm service to be anticompetitive.[24]

28. In addition, the Commission's determination in *DTI* does not preclude its action here. In *DTI,* the pipeline proposed a full service requirement provision as part of a negotiated contract with an individual shipper. The Commission stated that it permitted negotiated rate provisions that relate to contract prices to the level of service taken, but only if such a provision affected only the rate for the service and did not result in the customer receiving a different quality of service than that provided other customers under the tariff. However, the Commission found that the full requirements provision of the contract proposed by DTI constituted "a term and condition of service materially different than as provided under the FT Rate Schedule and does not appear to be a provision that affects only the rate for the service."[25] Therefore, the Commission required that the pipeline delete the full requirements provision from the contract at issue there. Cornerstone points out that the pipeline in *DTI* was not given the option, as was Northern in the instant proceeding, to rehabilitate its full requirements restriction by making the service generally available in its tariff and argues that this distinction reflects a broader skepticism regarding the full requirements restriction than the Commission expresses in the instant proceeding.

29. While the Commission's order in *DTI* may not have expressly given DTI the option to file under NGA section 4 to offer to make full requirements service generally available under its tariff, pipelines always have the right to propose modifications to their tariffs under NGA section 4. Moreover, subsequent to the Commission's decision in *DTI*, the Commission re-examined its policies concerning non-conforming contracts in *Columbia* and *ANR*.[26] In these cases the Commission found that where a material deviation in a non-conforming contract constitutes a negotiated term and condition of service, the Commission will require that the pipeline modify its tariff to offer this service to all of its customers or explain why it can only provide the service to the one

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[24] *Transcontinental Gas Pipe Line Corp.*, 76 FERC ¶ 61,021 at 61,061-63 (1996).

[25] *DTI,* 94 FERC at 61,260.

[26] *Columbia Gas Transmission Corp.*, 97 FERC ¶ 61,221 at 62,003 (2001) (*Columbia*) and *ANR Pipeline Co.*, 97 FERC ¶ 61,224 (2001) (*ANR*).

customer it negotiated with.[27] Therefore, the Commission's action in the instant proceeding was consistent with the Commission's policies concerning non-conforming contracts as set forth in *Columbia* and *ANR*.

30. Cornerstone also argues that Northern's full requirements/load growth provisions are inconsistent with the Commission's findings in *El Paso.* Cornerstone argues that the Commission determined that the root of the problem in the *El Paso* case was the lack of the ability for the pipeline to increase the full requirements customer's cost responsibility to meet the costs of incremental capacity that would have met the customer's increasing demand. Cornerstone asserts that the Commission held in *El Paso* that the full requirements contracts were "a disincentive to pipeline-to-pipeline competition and provide no incentive for the pipeline to provide for the necessary expansion."[28]

31. However, the instant case presents a substantially different situation than that faced by the Commission in *El Paso*. In sum, the full requirements contracts held by shippers in the *El Paso* proceeding did not provide a specific contract demand level and the pipeline received a fixed revenue amount regardless of amount of gas it transported for a certain full requirements customer. Therefore, the pipeline could not build on a cost effective basis to meet the needs of its full requirements customers. In the instant proceeding, the full requirements customers have signed contracts with specified contract demand levels. Further, Northern has agreed to provide CenterPoint with an option to increase its contract MDQ, in specified amounts at specified intervals thereby increasing the shipper's contract demand level and the accompanying fixed revenue based upon the increased demand charge. Northern also agrees to construct facilities if necessary to provide any increase in CenterPoint's MDQ growth needs for the entire term of the agreement at agreed-upon rates.[29] Therefore, the full requirements provisions in the instant case do not present the same infirmities as in the *El Paso* case.

C. <u>Posting Of Capacity</u>

32. The March 23 Order addressed protests by parties that Northern did not post the subject capacity to allow other shippers to bid on it. The parties argued that such action contravened the Commission's policy that pipeline capacity should be awarded to the

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[27] *Columbia* at 62,003; s*ee also, ANR* at 62,024. .

[28] Cornerstone Request for Rehearing at 23, *citing*, *El Paso* at 62,005-06.

[29] CenterPoint may exercise this "growth option" during successive two year periods with eighteen months' notice to Northern.

shipper that values it the most. The parties stated that because two of Northern's proposed agreements were discounted price agreements, Northern proposed to give CenterPoint access to capacity in the future at a discounted price without giving other potential shippers an opportunity to offer a higher rate and that such action was contrary to the Commission's decision in *GTN*.[30] The parties also argued that, due to the nature of the subject deal, there is no way to establish whether the award of a discount was required by the market.

33. The March 23 Order found that *GTN* was not applicable to the subject filing. The Commission explained that *GTN* sets forth Commission policy concerning the conditions under which a pipeline may reserve currently available, unsubscribed, capacity for a transaction to commence at a future date and then deny other shippers who may purchase the capacity in the interim a Right of First Refusal (ROFR). In the instant proceeding Northern did not propose to reserve unsubscribed capacity for a future date while denying a ROFR right to an interim shipper as was at issue in *GTN*, but rather, proposed to continue an existing shipper's use of its subscribed capacity. Therefore, the Commission found that the issue of Northern's ability to sell such capacity for future use without a ROFR as was at issue in *GTN* did not arise.[31]

34. The Commission also found that to the extent that the proposal allowed CenterPoint to extend the term of an existing shipper's contract without the participation of third parties, such action was not prohibited by Commission policy. The Commission stated that in *TransColorado*, it found that pipelines are permitted to rollover existing contracts at maximum or discounted rates without offering the subject capacity to other shippers.[32] Moreover, the Commission stated that to the extent that Northern's proposal requires it to build new capacity for Centerpoint, Northern has agreed to hold an open season for such capacity and to provide service to other shippers that bid at an economic level for such capacity.

35. Cornerstone argues that in *TransColorado* the discount arrangement was part of the original agreement and the issue was limited to whether it was permissible to extend the term of the agreement at the existing discounted rate. Cornerstone argues that in the instant case, the new rate, as well as the non-rate terms in the new agreements, presents a

[30] *Gas Transmission Northwest Corp.*, 109 FERC ¶ 61,141 (2004) (*GTN*).

[31] 110 FERC at P 25.

[32] *TransColorado Gas Transmission Co.*, 109 FERC ¶ 61,117 at P 9-10 (2004) (*TransColorado*).

different situation than a mere rollover of the preexisting agreements. Distributors add that the instant situation concerns entirely new contracts which supercede and replace the existing contracts and that the policy set forth by *GTN* should be followed and that *TransColorado* is inapplicable to the instant situation.

36. Cornerstone asserts that the issue presented here is whether, in the case of renewing long term firm agreements, the pipeline should be required to make its discount offer contingent on first confirming that there are no other shippers willing to pay more than the discounted rate. Cornerstone contends that the Commission must find that the new contracts offered to preexisting shippers must not be exempted from the competitive allocation process, so that the Commission's goal of allocating capacity to shippers who value it most is followed consistent with its current ROFR and general allocation policies. In the same vein, Distributors assert that without posting there is no way to know whether other shippers would be willing to contract for all or part of the capacity at the same or higher rates or whether the CenterPoint deal is necessary at all.

37. Many of the parties' arguments center on the Commission's policy regarding allocative efficiency and state that Northern's proposal to allocate capacity to CenterPoint without posting that capacity to give third parties an opportunity to offer a higher rate violates this policy. In the 1989 Rate Design Policy Statement,[33] the Commission stated its concern with allocative and productive efficiency and stated that it is a necessary objective but not the only objective considered by the Commission.[34] For example, in the Policy Statement the Commission noted that it has required the allocation of capacity using the "first-come first-served" principle but would, heretofore, consider a shift in emphasis to mechanisms and rates which more directly allocate capacity to those who value it more highly.

38. However, while the Commission articulated its goal of placing capacity in the hands of those that valued it most highly, the Commission assumes that the pipeline will always seek the highest possible rate from non-affiliated shippers, since it is in its own economic interest to do so. Accordingly, the Commission has not required pipelines to implement allocation mechanisms utilizing methodologies such as the Net Present Value (NPV) process which would allocate capacity to the shipper bidding the highest amount to the pipeline. Rather, the Commission has permitted pipelines to implement such an allocation methodology to the extent it believes such methodologies are necessary on its system in order to allocate scarce capacity to the highest valued use.

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[33] 47 FERC ¶ 61,295 (1989), *order on reh'g*, 48 FERC ¶ 61,122 (1989).

[34] *Id.* at 62,052-53.

39. Consistent with this policy, Northern's tariff permits it to hold open seasons for capacity based upon the NPV allocation methodology but does not require the use of such a methodology.[35] Northern is entitled to allocate its capacity consistent with the approved provisions of its tariff, and the parties have not shown that Northern did not do so in the instant proceeding. The parties point out that Northern has permitted CenterPoint to extend the term of the use of its current capacity subject to different conditions and argue that this distinguishes the instant proceeding from the Commission's finding in *TransColorado*, that the pipeline could extend the term of discounted capacity without following posting procedures for the capacity. Whether the instant proceeding involves more than a mere rollover of the capacity as the parties argue misses the point. The fact consistent in both proceedings is that the pipeline and the shipper extended the term of currently subscribed capacity. As stated above, the Commission will assume that the pipeline must consider that this is the highest value that it could obtain for the capacity until the matter is examined in the next rate case. Moreover, no party on rehearing stated that it was willing to obtain this capacity for itself.

40. Distributors also argue that CenterPoint has made an end run around the Commission's ROFR policies because instead of declaring its intention to utilize ROFR procedures to retain its capacity by matching the highest bid and term, under this process there is no bid to match. Distributors argue that the Commission should reject the service agreements outright or in the alternative, require Northern to hold a capacity auction for the capacity at issue.

41. The ROFR process is designed to protect the long-term captive customers that rely on pipelines for service from the pipeline's use of its monopoly power. Northern has permitted CenterPoint to extend the use of the capacity that it currently holds under new terms, thereby permitting it to continue the use of the capacity it currently holds. As Cornerstone points out, the Commission's policies do not prohibit the extension of capacity rights during the current term of the capacity.[36] Further, as stated above, the

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[35] *Northern Natural Gas Co.*, 110 FERC ¶ 61,361 at P 10 (2005) ("[H]owever, the Commission has not required pipelines to sell capacity solely through open seasons. Rather, so long as the pipeline posts all available firm capacity, it may sell that capacity on a first- come, first-served basis").

[36] Cornerstone Request for Rehearing at 13; *See also*, *Transcontinental Gas Pipeline Corp*., 87 FERC ¶ 61,109 (1999), *order on reh'g*, 88 FERC ¶ 61, 295 (1999).

Commission assumes that the pipeline has obtained the highest value for the capacity. The fact that the conditions of service under which the capacity is now utilized differ from its previous use does not violate the reasoning the Commission invoked in establishing a ROFR right, nor does the fact that the pipeline has permitted the shipper to renegotiate its use of capacity during the term of the capacity it currently holds without going through the ROFR process.

42. Cornerstone argues that by the terms of its agreements Northern would have no choice but to allocate CenterPoint capacity sufficient to meet its growth entitlement and that given this commitment it is possible that the pipeline would consider any capacity that becomes available on its system that could meet the CenterPoint demand to be reserved and, therefore, not available unallocated capacity subject to its tariff provisions. In such a case no other shipper would have any opportunity to obtain such future capacity.

43. However, under Northern's proposal, Northern must allocate any generally available capacity that could be used to satisfy the growth option in accordance with section 26 of its General Terms and Conditions.[37] Northern's proposal did not contain any statement that it would consider capacity that becomes available as reserved for the CenterPoint growth option nor does its tariff appear to contemplate such reservation of capacity. Therefore, Cornerstone's allegation that Northern would attempt to reserve such generally available capacity is without foundation.

44. Cornerstone also argues that if it offers all available future capacity to the highest bidder, Northern is still obligated, if existing capacity is insufficient, to construct additional capacity to meet CenterPoint's needs at the discounted rate. Cornerstone argues that this rate may bear no relationship to the economic feasibility of such construction and, therefore, CenterPoint obtains preferential treatment *vis a vis* Northern's other shippers because it gets more capacity at a pre-determined rate even if other shippers value the capacity more highly than CenterPoint. Accordingly, Cornerstone argues that the Commission must reverse its prior ruling and require that both the discounted rate capacity and the new load growth capacity be subject to a competitive allocation.

45. Cornerstone has hypothesized that if Northern offers future capacity to the highest bidder and after the bid is awarded the remaining capacity is insufficient to meet CenterPoint's needs, Northern is still obligated to meet CenterPoint's needs at a discounted rate even though other shippers may value the capacity more highly than

[37] 110 FERC at P 15.

CenterPoint. However, in this case no shipper bid for the remaining "insufficient amount" of capacity and any additional amount of capacity that Northern would construct to meet the rest of CenterPoint's needs would be subject to the same tariff provisions regarding the posting. CenterPoint would not receive capacity until no other shipper is willing to pay for the full value of the capacity. That CenterPoint might at that point obtain capacity at a discounted rate is consistent with the Commission's discounting policies and the Court's determination in *AGD*.

D. <u>Most Favored Nation Clause</u>

46. In its March 23, 2005 Order the Commission considered a proposal by Northern stating that if Northern ever provides a MFN provision to another shipper, Northern will provide that MFN provision to CenterPoint.[38] The Commission stated that it had held that in order to be permissible such clauses must relate only to rates and not result in the MFN customer receiving a different quality of service from other shippers or adversely affect other shippers.[39] The Commission found that if the pipeline desired to offer specific terms and conditions of service not found in the current form of service agreement or its tariff to a shipper, it must propose a tariff provision that is generally applicable and offer such rights to all shippers on a nondiscriminatory basis.

47. The Commission found that Northern's proposal was permissible because Northern's proposal, by itself, did not grant MFN status to CenterPoint. The Commission stated that Northern's proposal would grant CenterPoint MFN status if Northern grants such status to another shipper. Therefore, the Commission found that, under the proposal, Northern must first propose, and the Commission must grant an MFN clause, as to the third party. The Commission stated that if, pursuant to the terms of the subject agreements, Northern were to then propose to grant MFN status to CenterPoint, Northern would be required to file the provision and the Commission would consider such a filing

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[38] Paragraph 6 of Northern's proposed TFX Service Agreement states:

> [t]o the extent Northern provides a Most Favored Nation provision in the future to any Shipper in the Market Area during the term of this TFX Service Agreement, the TF Full Rate Agreement, the Trailblazer Agreement and the Letter Agreement (not including any extension as a result of the ROFR process), Northern will provide a similar provision to CenterPoint Energy Minnesota Gas.

[39] *Gulfstream Natural Gas System, L.L.C.*, 100 FERC ¶ 61,036 (2002), *order on reh'g*, 101 FERC ¶ 61,368 (2002).

to determine if the MFN clause as applied to CenterPoint is consistent with Commission policy. The Commission concluded stating that, "in this circumstance, the Commission finds Northern's proposed non-conforming term to be permissible given its attempt to retain the load on its system."[40]

48. Distributors argue that the Commission erred by stating that it should not address the discount issue in this proceeding, and then approving the MFV provision on the basis that it will help Northern retain the load its system and, presumably, will prevent cost shifts to other customers. Distributors argue that either rates are at issue in this proceeding or they are not. Distributors argue that if rate justifications are the basis for the Commission's conclusion that the service agreements should be approved, then all facets of the rates must be examined and decided now because it does no good to prevent cost shifting if the costs that are later passed through to other customers are equal to or higher than the costs that are avoided.

49. The fact that the Commission attempted to summarize Northern's claim that its general proposal would help it retain load for its system in the quoted language did not provide the basis for the Commission's finding that the MFN proposal was acceptable. As discussed above, whether this proposal helps Northern retain its load or prevent cost shift to other customers is a matter for a later proceeding. The Commission found the MFN clause to be permissible in the circumstances described because it did not violate the Commission's policies, in that the proposal did not grant MFN status upon CenterPoint. The Commission explained that CenterPoint would not receive MFN statues until the Commission approved a request for a MFN clause for a third party shipper on Northern's system and subsequently approved a request for CenterPoint to receive similar status. Because these necessary approvals would only be granted if the MFN clauses were consistent with Commission policies, the proposal was approved.

50. To the extent necessary, the Commission clarifies that this was the basis of the Commission's finding that Northern's MFN proposal was acceptable.

E. <u>Load Growth Promotion Payments</u>

51. Northern's proposal provided that Northern would supply market support dollars for CenterPoint to use in promoting load growth served by Northern. The proposal requires Northern to pay CenterPoint $250,000 annually through November 1, 2011; $275,000 annually through November 1, 2019; and, $300,000 annually through the agreement's termination, or no later than October 31, 2022.

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[40] 110 FERC at P30.

52. In the March 23, 2005 Order, the Commission determined that such payments are not prohibited by Commission policy, but that the payments were not to be viewed as a discount from the price that CenterPoint pays for transportation on Northern's system. The Commission found that such payments would constitute remuneration to CenterPoint for the service of promoting load growth and, therefore, would not be eligible to factor into any future discount adjustment sought by Northern. The Commission concluded by stating that this finding did not preclude Northern from seeking to recover this type of cost in a future rate case if it can show that this payment to one customer is sufficiently connected to service provided to other customers to justify requiring all customers to bear the cost.[41]

53. Distributors agree with the Commission that while such payments are not prohibited by Commission policy, the payments are not discounts to transportation service rates and are not eligible to factor into any future discount adjustment sought by Northern. However, the Distributors state that it is not certain what the Commission meant by stating that its finding does not preclude Northern from seeking to recover this type of cost in a future rate case if Northern can show that this payment to one customer is sufficiently connected to service provided to other customers to justify requiring all customers to bear the cost.

54. The Distributors argue that expense recovery in base rate proceedings is limited to just, reasonable, and ongoing expenses and the market support payments at issue here do not meet any of these tests. Moreover, Distributors argue that for the reasons it set forth with respect to discounts, the disposition of these costs, which have the potential to exceed $4 million cannot be something that can be left to a later date. Distributors argue that if Northern is able to recover these costs later, the cost shifts that the approval of these Service Agreements would allegedly avoid has no meaning. The Distributors submit that the Commission should hold that these payments are not recoverable from other customers.

55. Distributors have not set forth any reason which would compel the Commission to find that Northern may not attempt to recover the subject payments in a future rate case. Distributors are free to raise any objection to the recovery of these costs and Northern must show that the recovery is just and reasonable in that proceeding. The Commission finds that Distributors attempt to argue that the disposition of these costs cannot be left to a later date is without merit. As with the issue of discount set forth above, whether these expenses prevent a cost shift or help Northern to retain load is a matter to determine at a

[41] 110 FERC at P 27.

later date when Northern attempts to recover such costs. Distributors are free to present its arguments concerning the legitimacy of Northern's recovery of these load growth promotion payments at that time.

The Commission orders:

The requests for rehearing are denied as discussed in the body of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.