UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Gulf South Pipeline Company, LP — Docket Nos. RP06-355-001
RP06-355-002

ORDER ON REHEARING AND COMPLIANCE

(Issued April 10, 2007)

1. On July 10, 2006, the Indicated Shippers[1] requested rehearing of the Commission's June 8, 2006 Order in the above-captioned docket.[2] The Commission's June 8, 2006 Order accepted, subject to conditions, tariff sheets proposed by Gulf South Pipeline Company, LP (Gulf South), to revise its Right of First Refusal (ROFR) procedures to be effective June 9, 2006. As discussed below, the Commission grants the Indicated Shippers' request for rehearing in part and denies it in part.

2. In addition, on June 21, 2006, Gulf South filed revised tariff sheets[3] to comply with the Commission's June 8, 2006 Order. Except as discussed below, the Commission accepts the revised tariff sheets as in compliance with the June 8, 2006 Order.

I. Background

3. On May 9, 2006, Gulf South filed proposed tariff sheets to modify certain provisions of section 30 of its General Terms and Conditions (GT&C), which establishes the ROFR for firm transportation and storage service agreements. Gulf South stated that these changes will update and streamline its ROFR procedures, improve certainty for both shippers and Gulf South, and insure that the new provisions reflect the current market environment.

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[1] In the instant proceeding, the Indicated Shippers are BP Energy Company, BP America Production Company, and Chevron Natural Gas, a division of Chevron U.S.A. Inc.

[2] *Gulf South Pipeline Co., LP*, 115 FERC ¶ 61,301 (2006).

[3] Gulf South Pipeline Company, LP's June 21, 2006, Revised Tariff Sheets, Docket No. RP06-355-001. Specifically, Gulf South filed Substitute First Revised Sheet No. 3701, Substitute Fourth Revised Sheet No. 3702, Original Sheet No. 3702A, and Substitute Third Revised Sheet No. 3705 to its FERC Gas Tariff, Sixth Revised Volume No. 1.

4. On June 8, 2006, the Commission issued an order accepting Gulf South's proposed tariff sheets, to be effective June 9, 2006, subject to Gulf South filing revised tariff sheets within 15 days of the date of issuance of the order. Specifically, the Commission directed Gulf South to amend sections 30.2 and 30.3 to reflect the language in its May 26, 2006 answer, which provided for a maximum ROFR notice period of six months for contracts with terms shorter than two years, and one year for contracts with terms of two years or longer.[4] The Commission also directed Gulf South to make section 30.2(b) of its tariff consistent with the language in its answer permitting ROFR customers to change primary points on existing contracts during the time period between the date the ROFR capacity is awarded and the end of the service agreement.

5. On June 21, 2006, Gulf South filed revised tariff sheets to comply with the Commission's directive in its June 8, 2006 Order.

6. On July 10, 2006, the Indicated Shippers filed a request for rehearing of the June 8, 2006 Order.

II. Discussion of Rehearing Request

7. For the reasons discussed below, the Commission grants the Indicated Shippers' rehearing request in part and denies it in part.

A. ROFR Notification Period

8. Gulf South initiates the ROFR process for expiring service agreements with a notice to the shipper that the agreement is expiring. Before this proceeding, section 30.2 of Gulf South's GT&C provided that it would provide this notice at least 120 days before contract expiration, but no more than 150 days before contract expiration. Gulf South proposed to shorten the 120-day minimum notice period to 90 days and eliminate the 150-day maximum limit on when the notice must be given. In its answer to protests of the elimination of the 150-day maximum notice period, Gulf South stated that it would agree to provide the notice no more than six months before the expiration of contracts with terms shorter than two years, and no more than one year before the expiration of contracts with terms of two years or longer. The June 8, 2006 Order required Gulf South to modify proposed section 30.2 consistent with the proposal in its answer.

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[4] *Gulf South Pipeline Co., LP*, 115 FERC ¶ 61,301, at P 13 (2006).

9. The Indicated Shippers argue that Gulf South should not be allowed to provide ROFR notice to the existing shipper any earlier than 150 days prior to the existing agreement's expiration date. In support of its position, the Indicated Shippers point out that under Gulf South's proposed time frames for the remainder of the ROFR process after issuance of the instant notice, the open season for third party bids and any bid matching by the existing shipper would be completed within approximately one month of the issuance of the initial notice. The Indicated Shippers assert that this is contrary to the Commission's finding that bidding should "occur sufficiently close in time to the availability of the capacity in order to allow both the existing shipper and prospective shippers to determine the value of the capacity."[5] The Indicated Shippers assert that, under Gulf South's six month/one year maximum ROFR notice period, bidding would occur too far in advance for shippers to accurately assess the value of the capacity. Specifically, the Indicated Shippers believe Gulf South's six month/one year maximum ROFR notice period would make it hard for shippers to assess the pertinent basis differentials, which bear on the value of the capacity. The Indicated Shippers contend that with a 150-day maximum notice period, shippers could more accurately determine the value of the capacity.

10. The Commission denies the Indicated Shippers' rehearing request on this issue. The Commission has stated that, "under the ROFR, a reasonable period before a contract, normally six months to a year, a shipper would provide notice to the pipeline stating whether or not it was interested in renewing its contract."[6] Gulf South's proposal to initiate the ROFR process no more than one year in advance of the termination of contracts with terms of two years or more, and no more than six months in advance of the termination of contracts with terms of one to two years, is consistent with the time frames the Commission has previously approved for initiation of the ROFR process.

11. The Commission recognizes that, under Gulf South's proposal, if it does initiate the ROFR process one year in advance of the termination of a contract with a term of two years or more, the existing shipper would have to make a final determination whether to match a third-party bid for its capacity approximately eleven months before the termination of its contract. However, the Commission sees nothing contrary to Commission policy in this fact. A fundamental goal of the Commission's policies concerning the allocation of pipeline capacity, including in the context of a ROFR, is to

[5] *Id.* at P 11.

[6] *Transcontinental Gas Pipeline Corp.*, 103 FERC ¶ 61,295, at 62,152 (2003). *See Dominion Transmission, Inc.*, 111 FERC ¶ 61,135, at 61,714 (2005); *Transcontinental Gas Pipe Line Corp.*, 103 FERC ¶ 61,295, at 62,150 (2003); *Texas Eastern Transmission, LP*, 101 FERC ¶ 61,215, at 61,922 (2002), *order on reh'g*, 103 FERC ¶ 61,135, at 61,462 (2003).

enable those who value the capacity the most to obtain it.[7] Moreover, because it is generally in the pipeline's economic interest to sell capacity to those who value it the most, the Commission has allowed pipelines some degree of flexibility in how they market their capacity in order to accomplish that goal.[8]

12. Here, Gulf South seeks to retain the flexibility to initiate the ROFR bidding process any time within a period of one year to three months before the existing shipper's contract expires. Given the pipeline's interest in obtaining the highest value for the capacity, the Commission presumes that Gulf South will exercise this flexibility to initiate the ROFR bidding process at such time within the relevant period as it believes it can obtain the highest NPV third-party bids. For example, if the pipeline believes, based on its market knowledge, that most potential third-party bidders have long lead-times before they will be able to use the capacity because they are considering building a new plant or electric generator, the pipeline may initiate the ROFR bidding process as soon as possible. Alternatively, if the pipeline believes that most third-party bidders would be unwilling to make a commitment to purchase the capacity that far in advance of its availability, the pipeline would wait until later in the period to initiate the ROFR bidding process.

13. Giving Gulf South the flexibility to make these choices is consistent with the general policy favoring allocation of capacity to those who value it the most. In addition, to the extent Gulf South is able to use this flexibility to sell capacity for a higher rate or longer term than it otherwise could, Gulf South's other customers could be benefited when and if Gulf South files a new section 4 rate case, since the shipper who obtained the capacity may be responsible for a greater share of the pipeline's costs.

14. Finally, Gulf South's proposal permits initiation of the ROFR process more than six months before contract termination only if the existing shipper has a contract for two years or more. Shippers with such long-term contracts should be able to assess their continued need for long-term capacity up to eleven months in advance of the expiration of their current contracts, since long-term needs do not ordinarily change without warning. In addition, seasonal swings in the short-term value of the capacity are not

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[7] Order No. 636-A, at page 30,630 ("when a contract has expired, it is most efficient, within regulatory constraints, for the capacity to go to the person who values it the most, as evidenced by its willingness to bid the highest price for the longest reasonable term."). *Regulation of Short-Term Natural Gas Transportation Services and Regulation of Interstate Natural Gas Transportation Services, Order on Remand*, 101 FERC ¶ 61,127, at P 20, *order on reh'g*, 106 FERC ¶ 61,088, at P 17, *aff'd sub nom. American Gas Ass'n v. FERC*, 428 F.3d 255 (D.C. Cir. 2005).

[8] *See Northern Natural Gas Co.*, 111 FERC ¶ 61,379, at P 38-39 (2005), holding that pipeline can extend the contract of an existing shipper with a ROFR, without posting the capacity for third party bids.

particularly relevant to assessing the long-term value of the capacity. Accordingly, the Commission concludes it is not unreasonable for an existing long-term capacity holder to be required to make a final decision whether to extend its contract up to eleven months before contract termination.

B. Primary Point Changes

15. In its original filing in this docket, Gulf South proposed to revise section 30.2(b) of its GT&C in order to limit the ability of an existing shipper to change the primary points in both its existing and new contracts during certain periods. As revised in its answer to the protests, Gulf South proposed to prohibit the existing shipper from changing the primary points in its existing contract during the ROFR bidding process, i.e., while third parties were bidding on the existing shipper's capacity and the existing shipper was deciding whether to match any best third party bid. After that bidding process was completed and Gulf South had awarded a new contract to either the existing shipper or a third party shipper, the existing shipper would be permitted to change the primary points in its existing contract for the remaining term of that contract until the effective date of the new contract. However, Gulf South also proposed to prohibit the existing shipper or winning third-party bidder from changing the primary points in the new contract until the effective date of that contract. Gulf South stated that this was consistent with section 7.4 of its GT&C, which provides that it will not process amendments to a new service agreement until the service agreement takes effect. Accordingly, Gulf South argued its proposal would assure that all new firm service agreements are treated the same.

16. The June 8, 2006 Order approved Gulf South's proposal as modified in its answer. The Commission found that the revision addressed the protesters' concerns by permitting ROFR shippers to change the primary points in their existing contracts during the period from the date the ROFR capacity is awarded until the end of the contract.

17. On rehearing, the Indicated Shippers assert that the Commission erred by accepting the proposal to prohibit an existing shipper which has elected to renew its contract, from changing the primary points in its renewed contract until the effective date of the renewed contract. The Indicated Shippers argue that, when a shipper renews its contract through the ROFR process and then attempts to change its primary points, it is usually intending to make the change for both the remainder of the existing contract and the renewed contract. The Indicated Shippers contend that there is no reason for Gulf South to bifurcate its consideration of the primary point change by delaying the review of the change associated with the renewed contract until after it takes effect. The Indicated Shippers contend that this delay would preclude shippers from accessing new supplies or markets for an initial period after the commencement of the renewed contract. Finally, the Indicated Shippers argue that delaying the review of the primary point change will

result in existing shippers being treated differently than new shippers because the New Service Request provision does not apply to renewed contracts.

18. The Commission grants the Indicated Shippers' request for rehearing on this issue and finds that an existing shipper that decides to exercise its ROFR rights and renew its contract (Renewing Shipper) should be permitted to change the primary points in the renewed contract prior to its effective date. It is the Commission's policy that pipelines must permit shippers to change their primary points, as long as there is sufficient unsubscribed capacity available that the pipeline can guarantee firm service at the new point.[9] This instance is no exception.

19. The Commission has permitted pipelines to suspend an existing shipper's right to change its primary points during the ROFR bidding process, so that bidders will not be presented with a moving target as to what capacity they are bidding on.[10] However, after bidding is completed, there is no longer any reason to prohibit the existing shipper from exercising its right under Commission policy to change its primary points. Gulf South has recognized this fact in part, by agreeing to permit the existing shipper to change the primary points in its existing contract for the remaining term of that contract. However, as Indicated Shippers point out, if the existing shipper desires to change a primary point in its existing contract, it most likely will desire to make the same change in its new contract. Shippers generally change their primary receipt and/or delivery points because they desire to access different supplies or markets. The business reasons for the change are likely to continue beyond the expiration of the current contract. Preventing the shipper from making the change simultaneously in both the existing and new contracts would mean that the shipper would have no guarantee that it could retain a new primary point beyond the expiration of its existing contract. By the time the new contract took effect and the shipper could ask for the same primary point change in the new contract, Gulf South might have agreed to sell capacity using the new point to another shipper, with the result that it would no longer have sufficient capacity to permit the existing shipper to continue the primary point change in its new contract. This would complicate the shipper's pursuit of business opportunities at new points. The Commission sees no justification for such a limit on an existing shipper's right, pursuant to Commission policy, to change the primary points in its contract.

20. Gulf South's reliance on the provision in section 7.4 of its GT&C prohibiting new shippers from amending their contracts until those contracts take effect is misplaced. Renewing Shippers are existing customers who have decided to continue a contractual relationship, while New Shippers are not yet customers prior to the contract effective date. For this reason, the end of one contract period and the beginning of a new contract

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[9] *See Transcontinental Gas Pipe Line Corp.*, 103 FERC ¶ 61,295, at 62,171 (2003).

[10] *Northwest Pipeline Corp.*, 66 FERC ¶ 61,304, at 61,884 (1994).

period need not have the same relevance for a Renewing Shipper that the initiation of a contractual relationship has for a New Shipper.

21. Therefore, the Commission directs Gulf South to file revised tariff sheets to permit existing shippers who exercise their ROFR rights and renew their contracts, to change the primary points in their renewed contracts prior to the contracts' effective date.

C. Reinstatement of Shipper's ROFR Rights

22. Finally, the Indicated Shippers request rehearing of the Commission's finding that Gulf South does not have to reinstate an existing shipper's ROFR rights if the third-party bidder which submitted the best bid fails to execute a contract. The Indicated Shippers argue that if a winning third-party bidder reneges on its bid, the only way to ensure that the existing shipper has the opportunity to match the new winning third-party bidder's bid is to repost the capacity for bidding and permit the existing shipper to exercise its ROFR rights. The Indicated Shippers contend that doing so will best effectuate the purpose of the ROFR process, which is to protect the current shipper from losing its capacity upon the expiration of the contract. The Indicated Shippers believe that without reinstatement of the shipper's ROFR rights, third-party bidders may abuse the system by submitting artificially high bids with no intention of honoring them, simply to undermine existing shippers' ROFR rights. Finally, the Indicated Shippers contend that the Commission has endorsed the reinstatement of shippers' ROFR rights in previous orders and that the Commission is bound by this precedent.[11]

23. The Commission denies the Indicated Shippers' request to reconsider its decision accepting Gulf South's proposal not to reinstate an existing shipper's ROFR rights if a winning third party bidder refuses to execute a service agreement. While the Commission has accepted proposals by other pipelines to include provisions in their tariffs provisions of the type the Indicated Shippers seek here, the Commission has not held that the failure to include such a provision would render the pipeline's ROFR tariff provisions unjust and unreasonable. Thus, as Gulf South points out, the Commission previously accepted Gulf South's ROFR provisions for storage service which also do not contain such a provision.[12]

24. Gulf South has included provisions in its tariff which should strongly encourage any third parties bidding on an existing shipper's capacity to submit a *bona fide* bid, reflecting the true value the bidder places on the capacity. Most significantly, section 30.2(g) requires a winning bidder who fails to execute a contract to pay Gulf

[11] The Indicated Shippers July 10, 2006, Request for Rehearing at 13 (citing *Dominion Transmission, Inc.*, 111 FERC ¶ 62,135, at P 31 (2005)).

[12] *Koch Gateway Co*., 88 FERC ¶ 61,204 (1999), accepting section 30.0(g) of Gulf South's GT&C.

South the difference, if any, between the rate it bid and the rate Gulf South ultimately obtains when it resells the capacity. Once a shipper elects to forgo its ROFR rights by electing not to match the best third party bid submitted pursuant to these conditions, we will not require the pipeline to reinstate those rights upon a default by that third-party bidder. We believe it reasonable in these circumstances to permit the pipeline to seek another purchaser for the capacity, without the encumbrance of a ROFR for the existing shipper, which could reduce the willingness of third parties to submit bids.

25. The Indicated Shippers argue that this result is contrary to *Dominion Transmission, Inc.*, 111 FERC ¶ 61,135 at 61,718 (2005) (*DTI*), where the Commission stated that "if the winning third party bidder fails to ultimately execute a contract for the capacity, existing shippers generally would have 'a renewed opportunity for exercise of any applicable ROFR.'" However, the Commission stands by its explanation in the June 8, 2006 Order that the language the Indicated Shippers cite does not constitute a Commission policy that an existing ROFR shipper must receive a renewed opportunity to exercise its ROFR after a winning bidder fails to execute a service agreement. Rather, the Commission simply approved the pipeline's agreement during a technical conference to offer such a provision and found that *DTI* had adequately set forth its agreed-to provision in the tariff sheets it filed after a technical conference on the issue. Thus, the Commission denies the Indicated Shippers' request for rehearing on this issue.

III. <u>Discussion of Compliance Filing</u>

26. On June 21, 2006, Gulf South filed revised tariff sheets to comply with the Commission's directive in its June 8, 2006 Order that Gulf South revise proposed sections 30.2 and 30.3 of its tariff to provide that it will not give the notice initiating the ROFR process more than six months before the expiration of contracts with terms shorter than two years, or more than one year before the expiration of contracts with terms of two years or longer. In addition, Gulf South modified section 30.2(b) of its tariff to clarify that an existing shipper's response to that notification indicating its desired term and quantity for a new contract does not commit a customer to agree to that term or quantity later in the ROFR process when it decides whether to match the best third-party bid or what contract terms to negotiate if there is no third-party bid. Gulf South also modified section 30.2(b) to permit a ROFR customer to change primary points on its existing contract during the time period between the date the customer is notified of the best bid under section 30.2(e) and the date the service agreement ends.

27. Except with respect to the primary points issue discussed above, the Commission accepts Gulf South's revised tariff sheets as in compliance with the June 8, 2006 Order.

A. <u>Notice and Protests</u>

28. Notice of Gulf South's compliance filing was issued on June 23, 2006. Protests were due as provided in section 385.211 of the Commission's regulations (18 C.F.R. § 385.211 (2006)).

29. On July 3, 2006, Chevron Natural Gas, a division of Chevron U.S.A. Inc. (Chevron) filed a protest to Gulf South's compliance filing concerning the revised tariff sheets.

B. <u>ROFR Notification Provisions</u>

30. In its compliance protest, Chevron objects to the language Gulf South included in sections 30.2 and 30.32, which permits the parties to mutually agree that Gulf South will provide the initial notification initiating the ROFR process earlier than the generally applicable six month/one year ROFR notification cap. Chevron objects to the addition of the option to negotiate because it could trigger bidding before third-party shippers can accurately gauge the value of the capacity to them. Chevron contends that, with the option to negotiate the timing of the initial ROFR notification, certain shippers, such as those who serve captive loads, would have an unfair advantage because they could agree to have the pipeline initiate the ROFR process years in advance when few if any third parties would be willing to bid. Chevron also claims that allowing Gulf South to negotiate the notice period with shippers would create an intolerable risk of discrimination among shippers.

31. The Commission finds that the ROFR notification provisions in Gulf South's revised tariff sheets, including the option to negotiate, comply with the June 8, 2006 Order. The Commission created ROFR rights to protect the current shipper from losing its capacity upon the expiration of the contract without eliminating the pipeline's ability to earn the most it can for the capacity. Protecting shippers through ROFR rights ensures that the Commission can make the finding required by section 7 of the Natural Gas Act (NGA) that abandonment of service following contract expiration is in the public convenience and necessity.[13] However, the Commission also attempts to balance the

[13] *Tennessee Gas Pipeline Co. v. FERC*, 94 FERC ¶ 61,097, at 61,400 (2001). A short review of the development of ROFR rights emphasizes this point. As part of its adoption of open-access transportation, the Commission provided in Order No. 436 and then in Order Nos. 500-H and 500-I, automatic pre-granted abandonment for all firm transportation service under Part 284 blanket certificates. However, in *AGA Assoc. v. FERC*, 912 F.2d 1496, 1518 (D.C. Cir. 1990), the court found that pre-granted abandonment left customers inadequately protected. Subsequently, in Order No. 636, the Commission adopted ROFR rights to provide existing customers protection from the exercise of pipeline monopoly power at the end of a contract period. In reviewing Order No. 636, the court stated that to make a finding of public convenience and necessity that would support pre-granted abandonment under section 7 of the NGA, the Commission had to make appropriate findings that existing market conditions and regulatory structures protect customers from pipeline market power. *United Dist. Cos. v. FERC,* 88 F.3d 1105, 1139 (D.C. Cir. 1996). There, the court found that ROFR rights provided this protection and stated that the "basic structure of the right-of-first-refusal mechanism provides the protections from pipeline market power required for pre-granted abandonment under § 7." *Id.* at 1139.

interests of the pipeline by permitting it an opportunity to test the market value of its capacity. In doing so, the Commission assumes that the pipeline will always seek the highest possible rate from shippers. Based on this assumption, the Commission believes that, if the parties negotiate earlier ROFR notification, the pipeline must have determined that it would earn as much in agreeing to the earlier notification as it could expect if it waited until later. It would not be in the pipeline's interest to agree to start the ROFR process so far before the end of the contract, as few, if any, third parties would be willing to bid.

32. Therefore, even with the option to negotiate, Gulf South's six month/one year maximum ROFR notice period fulfills the purposes behind the ROFR rights. Gulf South's language protects the current shipper from losing its capacity upon the expiration of the contract and ensures that the capacity is sold at the rate which the pipeline has determined will return the highest revenue. Chevron's arguments concerning the impact of the option to negotiate on prospective third-party shippers holds little merit because the primary purpose of the ROFR rights are to protect current shippers, not prospective shippers. It is for these reasons that the Commission finds that Gulf South's ROFR notification provisions comply with its June 8, 2006 Order.

C. Shipper's Right to Renew Contract for Any Duration and MDQ

33. In its compliance protest, Chevron also requests that the Commission clarify that section 30.2(b), as revised in the compliance filing, does not undermine the existing shipper's right to renew its contract for any duration and MDQ if there is no best bid and the existing shipper is willing to pay the maximum tariff rate. Chevron does not deny that Gulf South has complied with the June 8, 2006 Order by revising section 30.2(b) to provide that an existing shipper's response to the initial notification starting the ROFR process indicating its desired term and quantity for a new contract does not commit a customer to agree to that term or quantity later in the ROFR process. However, Chevron wants to ensure that Gulf South's revisions to 30.2(b) do not bind the shipper to the contract duration in its ROFR response but, instead, allow the shipper to specify the contract duration and MDQ in its best bid response if the shipper is willing to pay the recourse rate. In the alternative, Chevron requests that Gulf South remove section 30.2(h) in order to eliminate the confusion caused when Gulf South does not receive bids during the bidding period, or does not accept and bids.

34. The Commission finds that an existing shipper need not commit to any term or volume amount prior to the submission of third party bids. A review of Gulf South's tariff indicates that if there are no third party bids on the capacity, or if Gulf South does not accept any of the third party bids, Gulf South and the original customer may negotiate the rate and term under which service will continue. Therefore, the Commission finds that Gulf South's proposal is consistent with the Commission's policies.

The Commission orders:

(A) The Indicated Shippers' request for rehearing is granted in part and denied in part, as discussed in the body of this order.

(B) Gulf South is directed to file revised tariff sheets containing language permitting existing shippers who exercise their ROFR rights and renew their contracts, to change their primary points before the effective date of the new contract, consistent with the discussion in the body of this order.

(C) Gulf South's June 21, 2006, filing is accepted as in compliance with the June 8, 2006 Order.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.