144 FERC ¶ 61,194
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Northern Natural Gas Company — Docket Nos. RP11-2061-005
RP11-2061-004

ORDER ON REHEARING AND COMPLIANCE FILING

(Issued September 11, 2013)

1. On December 20, 2012, the Commission issued its second order on rehearing and compliance filing concerning the reservation charge crediting provisions of Northern Natural Gas Company (Northern).[1] The December 2012 Order denied Northern's request for rehearing of the Commission's December 2011 Order in this proceeding[2] and required Northern to revise its reservation charge crediting tariff provisions both as to *force majeure* and non-*force majeure* events, to be consistent with Commission policy. On January 22, 2013, Northern filed a request for clarification or, in the alternative, rehearing of the December 2012 Order with respect to the reservation charge credits Northern should provide during *force majeure* outages. On January 22, 2013, Northern made its compliance filing.

2. This order grants Northern's request for clarification or rehearing, and accepts Northern's compliance filing, to be effective December 20, 2012, subject to conditions.

I. Request for Clarification or In the Alternative Rehearing

3. A primary issue in this proceeding has been how to apply the Commission's policy requiring pipelines to provide partial reservation charge credits during *force majeure* outages on Northern, in light of its non-straight-fixed variable (SFV) rate design. The Commission requires that pipelines with an SFV rate design provide partial credits pursuant to either (1) the No-Profit method under which the pipeline provides partial credits starting on the first day of the interruption in service equal to the portion of

[1] *Northern Natural Gas Co.*, 141 FERC ¶ 61,221 (2012) (December 2012 Order).

[2] *Northern Natural Gas Co.*, 137 FERC ¶ 61,202 (2011) (December 2011 Order).

the pipeline's reservation charge that represents the pipeline's return on equity (ROE) and associated income taxes, or (2) the Safe Harbor method under which reservation charges must be credited in full after a short grace period when no credit is due the shipper (i.e., 10 days or less), or (3) some other method that provides similar equitable sharing as under the other two methods.

4. The settlement of Northern's last rate case in 1995 allocated $16 million in fixed costs to Northern's usage charge. That amount represented about 3 percent of its total fixed costs. Prior to this proceeding, Northern's tariff contained no provision requiring it to give reservation charge credits during *force majeure* outages. When the issue of whether Northern should be required to provide such credits first arose in this proceeding, the Commission, in a June 2011 order, accepted Northern's contention that it need not provide such credits during *force majeure* outages, because the settlement of its last rate case included some fixed costs in Northern's usage charge. The June 2011 Order held Northern already shared the risk of *force majeure* outages because it is not collecting the fixed costs included in the usage charge during an outage.[3] On rehearing, the subsequent December 2011 Order found that Northern's inclusion of only about 3 percent of its fixed costs in its usage charge was too small an amount to accomplish an equitable sharing of the risks of *force majeure* outages comparable to the sharing under the approved sharing methods. The order required Northern to revise its tariff to grant partial reservation charge credit for *force majeure* events, but recognized that Northern could modify the Safe Harbor or No-Profit methods, to reflect that its usage charge includes 3 percent of its fixed costs. The order stated that the modification "might be an increase in the number of days at the outset of the Safe Harbor method when no credit is due or adjust the amount of credit under the No-Profit method."[4]

A. **The December 2012 Order**

5. Northern sought rehearing of the December 2011 Order, and also made a compliance filing. On rehearing, Northern contended it should not be required to provide any reservation charge credits during *force majeure* outages. The compliance filing included a hybrid proposal for crediting of *force majeure* events that consisted of a 15-day Safe Harbor period with no credit granted, followed by a 15-day period with full credit to the shipper, followed by crediting of all subsequent days using the No-Profit calculation, namely that portion of its reservation charge that represents return on equity

[3] *Northern Natural Gas Co.*, 135 FERC ¶ 61,250 (2011) (June 2011 Order).

[4] December 2011 Order, 137 FERC ¶ 61,202 n.30.

and associated income taxes. Northern stated that it recognized that the proposal differed from the Commission-approved Safe Harbor method but contended that the change was justified because Northern allocates some fixed costs to the usage charge. Thus, it claimed that it shared the risk because it does not recover the fixed costs in the usage charge when there is a *force majeure* outage.

6. The December 2012 Order denied rehearing, reaffirming the Commission's holding that Northern's inclusion of 3 percent of its fixed costs in its usage charge does not result in risk sharing remotely close to the risk sharing under the two approved methods for SFV pipelines. The Commission also rejected Northern's hybrid proposal for the crediting during *force majeure* outages. After comparing the risk sharing under the No-Profit and Safe Harbor methods with the risk sharing under Northern's proposal, the Commission concluded that Northern's hybrid proposal cherry picks the most pipeline-favorable aspects of each method by (1) requiring shippers to bear most of the risk of shorter term outages of 15 days or less, while (2) providing a percentage refund for the less likely longer-term outages of more than 24 days that is only marginally higher than that provided by the No-Profit Method.

7. The December 2012 Order then discussed what adjustments Northern could make to the approved No-Profit and Safe Harbor Method in light of its inclusion of 3 percent of its fixed costs in its usage charge.[5] With respect to the No-Profit method, the December 2012 Order found that ROE and associated taxes constitute about 40 percent of the total fixed costs included in Northern's cost of service pursuant to the 2005 Settlement.[6] The December 2012 Order then held that:

> In order to provide risk sharing equivalent to that provided under the No Profit Method by a pipeline with an SFV rate design, Northern could revise its tariff to provide reservation credits equal to 37 percent of the fixed costs in its reservation charge for every day of a *force majeure* outage. Those credits, combined with the fact Northern would not be collecting the 3 percent of its fixed costs included in its usage charge, would

[5] Because Northern has only requested rehearing of the December 2012 Order's findings concerning the No Profit Method and has adopted that method in its compliance filing, we need not describe the December 2012 Order's holdings with respect to the Safe Harbor Method.

[6] December 2012 Order, 141 FERC ¶ 61,221 at P 22.

> result in Northern forgoing the 40 percent of its fixed costs comprised of ROE and associated income taxes during the *force majeure* outage, consistent with the No Profit Method.[7]

B. Northern's January 22, 2013 Rehearing Request

8. Northern asserts that the Commission erred in its calculation of the appropriate percentage to use under the No-Profit method. Northern states that the Commission, in the December 2012 Order concluded that ROE and associated income taxes comprised 40 percent of Northern's fixed costs using the items listed in Appendix C to Northern's last settlement in 2005. Specifically, the Order at P 22 stated:

> While the uncontested settlement of Northern's last rate case included 3 percent of its fixed costs in its usage charge and thus Northern would not recover that amount during a *force majeure* outage, that amount is not remotely close to its ROE and associated taxes. Appendix C to the 2005 Settlement indicates that Northern's current rates are based on a total annual cost of service of $481 million. That cost of service includes a return on equity of $131,955,871 and Federal and state income taxes of $56,975,258. Thus, the total return and associated income taxes is $188,931,129, which constitutes almost 40 percent of Northern's total cost of service. However, Northern's usage charge, which includes $16 million fixed costs, only recovers about 3 percent of its total fixed costs.

9. Northern contends the Commission erred in assuming that the amount of $131,955,871 listed in Appendix C as "return" was return on equity. Northern asserts that the amount labeled as "return" is the amount of Northern's overall return, which covers both return on equity and its interest expense.

10. In order to calculate the actual return on equity, Northern refers to the 2005 settlement which states that "[f]or purposes of settlement, the pre-tax return is 13.42 percent," citing page 4 of the 2005 Settlement, Attachment 2 to its request. Northern contends the 2005 Settlement pre-tax return of 13.42 percent was based on an imputed return on equity of 12.00 percent and an overall return of 9.39 percent. These figures, Northern states, as shown on attachments to its request, indicate (1) debt of

[7] *Id*. P 72.

$800,000,000 (47.66 percent of capitalization) at a cost of 6.53 percent for a rate of return of 3.11 percent; and (2) equity of $878,587,595 (52.34 percent of capitalization). These amounts Northern has taken from an updated Statement F(2) in the 2005 rate case reflecting the actual capitalization at the end of the test period. Northern further states that the 9.39 percent overall return, comprised of 12 percent return on equity and 6.53 percent for debt, has been utilized by Northern in Section 7 certificate applications filed by Northern since the 2005 Settlement. Using these figures, Northern calculates a return on equity of $87,019,088, to which it adds associated taxes of $55,812,703, for a total "Return" of $142,831,396. When this amount is applied to the total cost of service of $480,612,919 in the 2005 Settlement, Northern calculates that ROE and associated income taxes comprise 29.72 percent of its fixed costs. Northern then concludes that with a rebate of 3.34 percent to reflect the fixed costs in the usage charge not collected by Northern, this results in 26.38 percent for the No Profit reservation charge credits.

11. Accordingly, in its request for clarification or rehearing of the December 2012 Order, Northern requests the Commission clarify that ROE and associated income taxes comprise only 29.72 percent of its current rates, and therefore it may provide reservation charge credits during *force majeure* outages limited to 26.38 percent of its reservation charge. In its compliance filing, Northern proposes to provide reservation charge credits in this amount under the No-Profit Method.

12. Indicated Shippers [8] filed an answer to Northern's request for clarification as well as a protest to Northern's compliance filing. They assert that the Commission should deny the clarification request and require Northern to modify its compliance filing to provide credits under the No Profit Method equal to 37 percent of its reservation charges.

13. Indicated Shippers also object that Northern uses certain amounts in its calculation that differ from the amounts in the 2005 Settlement, specifically the differing amounts for Federal Income Taxes. Indicated Shippers argue that if Northern's calculation were correct the figures should be the same. They also argue that the 2005 settlement was a "black box settlement" resolution of the issues so no participant's litigation position can be imputed in the 2005 Settlement.

[8] Indicated Shippers are Apache Corporation, BP America Production Company and BP Canada Energy Marketing Corp., Chevron U.S.A. Inc, Conoco Phillips Company, Occidental Energy Marketing , Inc and Shell Energy North America(U.S.) L.P.

C. Commission Determination

14. None of the Indicated Shippers' contentions have merit. They argue the 2005 settlement was a "black box settlement" resolution of the issues so no participant's litigation position can be imputed in the 2005 Settlement. In order to apply the No Profit Method to a pipeline whose current rates were established by a black box settlement, it is necessary to estimate the percentage of the settlement cost of service comprised of ROE and associated income taxes. While there may be situations where the information filed with the settlement is insufficient to permit a reasonable estimate of this percentage, thus foreclosing the pipeline from using the No Profit Method, this is not such a case. Even though the imputed return on equity is not stated in the 2005 Settlement, the attachments to Northern's 2005 rate case settlement contain sufficient information to make a reasonable estimate of the ROE and associated income taxes included in the settlement cost of service, thus permitting Northern to use the No-Profit Method in order to equitably share the risk of *force majeure* outages.[9] Indicated Shippers have not seriously challenged the figures Northern referenced to arrive at what it claimed as the correct percentage for ROE and associated income taxes. In fact, Indicated Shippers did not address Northern's contention that the word "return" in the 2005 Settlement could not mean ROE because there was no amount assigned to interest expense in the settlement, and Northern clearly has a capital structure that includes both equity and debt.

15. While Indicated Shippers assert that Northern uses certain amounts in its calculations that differ from the amounts in the 2005 settlement, Northern acknowledged in its request that the amounts for federal and state taxes on Appendix C to the 2005 Settlement (Attachment 1), which total $56,975,058, differ slightly from the amounts for federal and state taxes in Northern's calculation on Attachment 3 to its request, which totals $55,812,303. This, Northern explains is due to the effect of the "Settlement Adjustment" of $6,935,322, shown on line 9 of the settlement amounts.

16. Accordingly, the Commission grants Northern's request for rehearing and clarification and finds that ROE and associated taxes constitute 29.72 of its fixed costs. In order to determine the amount of the credit, the fixed costs in the usage charge amounting to 3.34 percent may be deducted from that percentage, resulting in a reservation charge credit of 26.38 percent, as Northern proposed in its compliance filing.

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[9] *See Texas Gas Transmission, LLC*, 141 FERC ¶ 61,223, at P 61 and P 65 (2012), where the Commission similarly estimated the ROE included in the pipeline's cost of service for purposes of applying the No-Profit Method.

The Commission will also accept Northern's compliance filing with respect to *force majeure* outages.

II. <u>Northern's January 22, 2013 Compliance Filing and Other Tariff Changes</u>

17. The December 2012 Order also required Northern to make other changes to the *pro forma* tariff records it filed to comply with the June 2011 Order. The changes required by the December 2012 Order included the following: (1) removing all provisions related to "Required Deliveries" and "Undelivered Quantities;" (2) removing all provisions related to the proposed claim procedure; and (3) clarifying that the credits provided to releasing shippers will be unaffected by any reservation charge credits provided to the replacement shipper. On January 22, 2013, Northern made a compliance filing which included all of these changes.

18. In addition to removing certain provisions required by the December 2012 Order and revising the tariff provision for credit during *force majeure* outages, Northern also made certain other revisions.

19. Northern added a new defined term, "Shipper's Nominated Quantities" in section 22.C.4, which Northern proposes to use in place of Required Market Deliveries in the determination of a shipper's applicable reservation charge credits.

20. In section 22.D.3, Northern added a provision addressing situations where a shipper whose nomination has been cut during the Timely nomination cycle subsequently nominates on another pipeline, consistent with the Commission determination in *Wyoming Interstate Company, LLC,* 130 FERC ¶ 61,091 (2010).

21. In section 22.G.3 Northern added a provision for partial reservation charge crediting for outages required by Pipeline and Hazardous Materials Safety Administration (PHMSA) orders pursuant to section 60139(c), Maximum Allowable Operating Pressure (MAOP), of Chapter 601 of Title 49 of the United States Code (Section 60139(c)). Northern argues that its proposal is consistent with Commission policy adopted in recent Commission orders (citing *Gulf South Pipeline Co., LP*, 141 FERC ¶ 61,224 (2012); *Texas Gas Transmission, LLC*, 141 FERC¶ 61,223 (2012); and *Gulf Crossing Pipeline Co., LLC*, 141 FERC ¶ 61,222 (2012)).

22. Indicated Shippers and the Northern Municipal Distributors Group and Midwest Region Gas Task Force Association (NM) filed protests to Northern's compliance filing. Northern filed an answer to the protests. The Commission will accept the answer to the protests since it presents a more complete record.

A. **PHMSA**

23. Indicated Shippers and NM protested that for the first time Northern proposes to add the PHMSA provisions. They contend that the Commission should not permit Northern to add completely new provisions in its compliance filing and they cite section 154.203(6) of the Commission's regulations which requires a compliance filing "must only include those changes to comply with the order." Moreover, they state the orders Northern relies on for adding this provision are subject to pending rehearing requests so the policy may be changed and thus Northern's proposal is premature. They argue rejecting the proposal would not preclude Northern from making a future filing to demonstrate that such an event is a *force majeure* event under Northern's tariff.

24. In its answer Northern argues that its proposal is consistent with Commission policy adopted in recent Commission orders, and the fact that there are pending requests for rehearing does not change that those orders are valid and in effect. Northern argues that it cannot anticipate when a particular MAOP order under section 60139(c) will be issued, or what that order may require. Indicated Shippers also argue that Northern has mechanisms in place to avoid or minimize curtailments while NM claims that Northern has had ample notice and opportunity to schedule a reconfirmation of MAOP during a time when curtailments could be avoided or minimized. Northern's response is that it will not have control over when it may receive a directive from PHMSA and Northern must comply with whatever action the PHMSA order requires. Further, Northern argues that it may or may not be able to use any of the mechanisms that it currently has in place to operate its system under currently known conditions when it is time to implement whatever actions PHMSA may require in the future. Northern concludes that its proposal is for the transitional period of two years, consistent with what the Commission has approved for other interstate pipelines.

25. While Northern's proposed PHMSA provision goes beyond what the December 2012 Order required, nevertheless it is clearly related to the reservation charge crediting issue. The provision, limited to the two year period commencing January 1, 2013, is similar to PHMSA provisions other pipelines have proposed which the Commission accepted.[10] The Commission agrees that even though rehearing is pending in those cases, it does not alter the fact that current Commission policy permits such a provision.

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[10] *See Gulf South Pipeline Co., LP,* 141 FERC ¶ 61,224 (2012); *Texas Gas Transmission, LLC*, 141 FERC ¶ 61,223 (2012); and *Gulf Crossing Pipeline Co., LLC,* 141 FERC ¶ 61,222 (2012).

Accordingly, rather than require Northern to make a separate filing to add this provision to its tariff, the Commission accepts Northern's proposed PHMSA provision.

B. Average Daily Delivery

26. Northern proposed in section 22.C.ii a revised provision concerning the calculation of reservation charge credits, when it provides notice of an outage before the deadline for submitting nominations in the Timely Nomination Cycle. If the shipper does not submit a scheduling nomination for that day, the reservation charge credits will be based on the average deliveries to the shipper at its primary delivery points during the immediately preceding seven days. If the outage continues beyond the first calendar month, the quantity for calculating the credit would be the average daily deliveries of the same calendar month of the previous year. If the shipper submits a nomination for the day in question despite Northern's notice that service will not be available, Northern proposes that the credits be based on the lesser of the historical deliveries described above or the quantities nominated by the shipper.[11]

27. Northern's proposal to provide credits when the shipper nominates service even though advance notice of an outage has been given based on the "lesser of" a shipper's nomination or the shipper's historical usage, is contrary to Commission policy. Where a pipeline has given advance notice of an outage, the Commission requires that credits for that day must be based solely on a measure of each shipper's historical usage, and not on the shippers' nominations.[12] Moreover, Northern has not explained why, if the shipper's nomination were to be used, it should only be used if the nomination is less than the otherwise applicable measure of historical usage. Therefore, the Commission directs Northern to revise this section to provide that where advance notice has been given, the reservation charge credits must be determined based on the applicable historical usage.

28. Indicated Shippers and NM also object to Northern's proposal to use historical data from the preceding year in certain circumstances. Indicated Shippers argue that the proposal goes beyond the December 2012 Order. Further, they contend the proposal is not consistent with the Commission's seven-day average policy. NM similarly objects to

[11] In all cases, the credits are capped at the amount of the shipper's contract demand.

[12] *Viking Gas Transmission Co.*, 142 FERC ¶ 61,054, at P 25 (2013); *Rockies Express Pipeline LLC*, 142 FERC ¶ 61,075, at P 32 (2013); *Dominion Transmission Inc.*, 142 FERC ¶ 61,154, at P 41 (2013).

the proposal, arguing that the use of a day-to-day comparison for the immediately preceding year is not a comparable period. NM also objects to Northern's proposal that if a shipper has increased or decreased its maximum daily quantity (MDQ) since the last year it will make a *pro rata* adjustment to nominations.

29. In response, Northern asserts that its proposal is in compliance with the order that directed Northern to remove the provisions related to “Required Deliveries” and “Undelivered Quantities.” The compliance filing removed those provisions and accordingly it was necessary to define which volumes will be used to calculate the shipper’s credit. Northern contends that its proposal for long-term outage is consistent with Commission policy. That policy recognized that for longer term outages it may be possible to base the credits on a shipper’s usage of its primary firm service during a comparable period of the prior calendar year or years.[13]

30. Northern asserts that the average daily volumes for the same month of the previous year is an appropriate historical average of usage on Northern’s system because Northern’s system is temperature sensitive. Northern explains that if an outage continues from summer to winter, for example, the volumes delivered during the seven summer days prior to the outage is not an appropriate measure of the volumes that would be delivered in the winter. As to NM’s objection, Northern argues that they misunderstand Northern's provision. Northern states it is not proposing a day-to-day comparison but is using the average of the entire month of the previous year.

31. The Commission has recognized that no method for outages with advance notice can guarantee that it is an accurate predictor of what would have happened. The Commission finds that Northern's proposal for long-term outages is reasonable because it is based on operational facts on Northern's system. Moreover, where a shipper has increased or decreased its MDQ, it is likely that nominations would increase or decrease accordingly. Therefore, the Commission will accept Northern's compliance filing, subject to the revision required above.

<u>The Commission orders</u>:

(A) The percentage credit under the No-Profit method is clarified on rehearing as discussed in the body of this order.

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[13] *Citing Kern River Gas Transmission Co.*, 140 FERC ¶ 61,146, at P 12 (2012).

(B) Northern's compliance filing is accepted, effective December 20, 2012, subject to Northern's filing, within 15 days of the date this order issues, revised tariff records to be effective December 20, 2012, as directed in the body of this order.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.