111 FERC ¶ 61,231
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Northwest Pipeline Corporation Docket No. RP05-286-000

ORDER ON TARIFF SHEETS

(Issued May 20, 2005)

1. On April 22, 2005, Northwest Pipeline Corporation (Northwest) filed tariff sheets[1] to revise the permanent capacity release provisions in section 22.5 of the General Terms and Conditions (GT&C) of Northwest's tariff. Northwest's tariff sheets are accepted to be effective May 23, 2005, subject to the conditions set forth below. This order is in the public interest as Northwest's initiatives provide more flexibility and greater transportation options for both releasing and replacement shippers on Northwest's system.

Proposal

2. Northwest's proposed tariff provisions concern permanent capacity release provisions for exit fees, eligibility criteria, and bidding procedures.

Permanent Capacity Release Exit Fee

3. Northwest's existing permanent capacity release exit fee provisions provide an option for the replacement shipper to pay Northwest a lower rate for permanently released capacity than the releasing shipper is paying, subject to the releasing shipper paying a lump-sum exit fee to Northwest equal to the net present value difference between the released contract and replacement contract. Northwest proposes to replace the existing exit fee provisions with new sections 22.5(a)(iv) and (v). Section 22.5(a)(iv), as proposed, requires all bids for a permanent capacity release to be equal to or greater than the releasing shipper's contract rate for the remainder of

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[1] Third Revised Sheet No. 271-A and Original Sheet No. 271-B to FERC Gas Tariff, Third Revised Volume No. 1.

the releasing shipper's contract term. Northwest states that this new provision eliminates the potential need for an exit fee payment to Northwest and is consistent with similar restrictions in other pipeline tariffs. [2] Northwest further states that its proposal is consistent with long-standing Commission policy that a pipeline need not discount its rates.[3]

4. Northwest's new section 22.5(a)(v) establishes a new exit fee alternative to enable a releasing shipper to permanently release capacity for which it is paying a higher rate than potential replacement shippers may be willing to pay. Northwest's proposed new exit fee option involves a "reverse auction" process to determine the level of a lump-sum exit fee that the releasing shipper would pay directly to the replacement shipper as consideration for the replacement shipper agreeing to acquire the permanently released capacity from Northwest at a rate equal to or greater than the releasing shipper's rate. If the releasing shipper opts to include an exit fee in its release offer, it would designate the maximum acceptable exit fee. Bids for the offered capacity then would specify both the rate and term to be paid by the bidder to Northwest and the associated exit fee to be paid by the releasing shipper to the bidder. Northwest would determine the winning bid based upon the total value of the capacity to the bidder, *i.e.*, net present value of the bid transportation rate reduced by the exit fee.

5. Northwest states its proposed restructuring of its permanent capacity release exit fee provisions also is consistent with the reverse auction process Northwest recently used to effectuate the permanent release of maximum rate contracts by Duke Energy Trading and Marketing, L.L.C. (DETM) to a replacement shipper willing to acquire the capacity at Northwest's maximum rates in consideration for a lump-sum payment by DETM to the replacement shipper.[4] Northwest states that, in particular, its proposed reverse auction process in new section 22.5(a)(v) satisfies the four prerequisite conditions identified by the Commission in Docket No. RP04-575:

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[2] *See* the General Terms and Conditions of the following pipelines for permanent capacity release provisions requiring a replacement shipper to pay the maximum rate (Kern River Gas Transmission Co., GT&C Section 15.2(e) and Southern Natural Gas Company (GT&C Section 22.3(a)).

[3] *See, e.g., Pan-Alberta Gas (U.S.) Inc. et al.*, 101 FERC ¶ 61,249 at P 14 (2002), citing Order No. 636-B, 61 FERC ¶ 61,272 at 62,028 (1992).

[4] The necessary tariff waivers for this process were granted by the Commission in *Northwest Pipeline Corp., Duke Energy Trading and Marketing, L.L.C.,* 109 FERC ¶ 61,044 (2004) (Docket No. RP04-575-000).

(1) Northwest will conduct the auctions and be bound by the results; (2) auctions will be conducted in an open and transparent manner consistent with capacity release regulations; (3) auctions will be open to any qualified bidder under Northwest's tariff provisions; and (4) any resulting payment from the releasing shipper to the replacement shipper will be made in a lump-sum form.[5]

6. Northwest noted that, under its existing exit fee provision, the prescribed calculation methodology may result in exit fees that would not leave Northwest and its ratepayers financially indifferent to a permanent capacity release, since such fees would not incorporate the impacts of potential future rate increases over the remaining term of the releasing contract.[6] Northwest states its current exit fee provision in effect does not provide a viable option for a shipper to release maximum rate capacity for resale to a discount rate replacement shipper.[7]

7. Northwest states that its proposed new exit fee tariff provisions will ensure that permanent releases are structured to keep Northwest and its rate payers whole in the event of future rate increases. Further, Northwest states that eliminating Northwest's tariff responsibility to calculate, collect and account for potential exit fees will eliminate the potential for disputes about the discount factor for net present value calculations that Northwest has the discretion to select for determining an exit fee, or about the subsequent accounting and rate treatment for exit fees collected.[8]

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[5] *Id.* at P 14.

[6] Northwest states that for example, a shipper with a contract subject to the maximum tariff rate as it changes from time to time could attempt to circumvent its future cost responsibility by prearranging a permanent release to an affiliate at a discount rate that would not be subject to upward rate case adjustments, while expecting to pay an exit fee based only on the net present value difference between the releasing contract at the current maximum rate and the replacement contract at the stated discounted rate.

[7] Northwest states, however, to date no shipper has requested Northwest to implement a permanent release at less than the maximum rate for the replacement shipper.

[8] New section 22.5(a)(v) specifically states that the cash flow discount factor for the new present value calculations will be the latest annual interest rate published quarterly by the Commission as posted on the Commission's Internet Website, unless specified by the Releasing Shipper.

Permanent Capacity Release Parameters

8. Northwest proposes to add a sentence to section 22.5(a)(i) explicitly reserving its right to deny any permanent capacity release request that it has a reasonable basis to conclude would not leave it (and thus its ratepayers) financially indifferent. Northwest states this right is consistent with Commission policy.[9]

9. Northwest also proposes to add a clause in section 22.5(a)(i) and new provisions in section 22.5(a)(ii) to clarify two other parameters for permanent capacity releases. The added clause in section 22.5(a)(i) explicitly notes that a shipper may permanently release its residual rights to capacity that is encumbered by temporary capacity releases. The new provision in section 22.5(a)(ii) establishes that a shipper may permanently release firm capacity acquired under a temporary capacity release, in the event such shipper also holds the corresponding rights under the associated base contract and is concurrently permanently releasing such base contract rights.

10. Northwest states that it has not allowed permanent releases of capacity encumbered by existing temporary capacity releases unless the releasing shipper first recalls its temporarily released capacity, and also has not allowed permanent releases of capacity acquired under a temporary release. Northwest states the one exception to these general restrictions was the DETM permanent release case cited above, where Northwest was granted waivers to "permit the permanent releases of capacity even as encumbered with temporary releases" and to "permit replacement shippers to assume permanently released contracts as proposed".[10] However, Northwest notes that the Commission also clarified that DETM could not permanently release capacity acquired under a temporary release when another shipper held the associated base contract capacity.[11]

11. Northwest states that its proposed tariff clarifications of permanent capacity release parameters will enhance a potential releasing shipper's permanent release flexibility without impacting other shippers. Northwest states a permanent release of base contract capacity encumbered by temporary releases will not invalidate any rights of the temporary capacity release replacement shippers. Likewise, Northwest

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[9] *See Texas Eastern Transmission Corp.*, 82 FERC ¶ 61,118 (1998), *Order on Reh'g and Clarification*, 83 FERC ¶ 61,092 at 61,446 (1998) (permitting pipeline to refuse to permit a permanent release when the pipeline has a reasonable basis to conclude that it will not be financially indifferent to the release).

[10] *See Northwest, supra* at P 9 and footnote 9.

[11] *Id.* at P 15.

asserts, the limited right to permanently release temporary capacity contracts in conjunction with permanently releasing the corresponding rights under the associated base service agreement will not alter the status of such temporary releases – the replacement shipper would simply assume the temporary capacity release rights and obligations formerly held by the permanently releasing shipper.

Permanent Capacity Release Bidding

12. Northwest states that, as discussed above, its proposed new section 22.5(a)(iv) defines the minimum acceptable bid for a permanent capacity release.[12] In addition, Northwest proposes new provisions in section 22.5(a)(iii) to establish that a prearranged permanent release at maximum rate for the remainder of the releasing shipper's term will not be exempt from competitive bidding. Northwest states that such releases will be biddable based on term unless Northwest determines that the underlying capacity will not be available beyond the end of the releasing shipper's contract term.

13. Northwest states its proposal will make Northwest's treatment of prearranged permanent capacity release offers more consistent with its treatment of prearranged offers for available capacity under section 25.2(d) of its GT&C.[13] Northwest states that, for available capacity, Northwest posts prearranged maximum rate offers for competitive bid to allow other shippers an opportunity to acquire the capacity by bidding a longer term.[14]

[12] New section 22.5(a)(iv) requires all bids for a permanent capacity release to be equal to or greater than the releasing shipper's contract rate for the remainder of the releasing shipper's contract.

[13] Under Northwest's posting requirements for available unsubscribed capacity and capacity that becomes available due to expiring or terminating agreements, section 25.2(d) provides that the Transporter may enter into a pre-arranged service agreement with any party for available unsubscribed capacity or capacity that will become available under an expiring or terminating agreement; provided that Transporter will post the terms of the pre-arranged transaction in accordance with sections 25.2(a), (b) or (c) above, and other parties will have an opportunity to bid on the capacity.

[14] Citing a Director letter order issued December 1, 2004 in *Gulf South Pipeline Company, L.P.*, Docket No. RP05-64-000 (authorizing Gulf South to post maximum rate service requests for competitive bid to allow other customers to increase the term of the initial request, subject to available capacity).

14. Northwest states that by making maximum rate prearranged permanent releases, including releases that involve an exit fee under section 22.5(a)(v), biddable on term is consistent with the Commission's policy objective of ensuring that available capacity is acquired by the party that values it the most. Northwest states that, for example, in eliminating the term matching cap for capacity subject to a right of first refusal, the Commission found that a term cap distorted the bidding process and interfered with allocating pipeline capacity to the shippers placing the highest value on the capacity.[15]

15. Northwest states that its proposed bidding requirement will encourage longer-term contracting for capacity which, as the Commission articulated in Order No. 636-A, will generally benefit the system as a whole because long-term contracts provide stability and benefits to all customers.[16] Northwest states that on its system, all but one existing maximum rate, long-term firm shipper has evergreen rights (*i.e.*, after the primary term, the contract continues on a year-to-year basis until termination notice is given) and, in most cases only the shipper has the right to provide the termination notice. Accordingly, Northwest asserts that although it must ensure that the underlying capacity is available in perpetuity, a maximum rate contract currently could be permanently released to a prearranged maximum rate shipper for the remaining primary term (which may be as short as one year) along with the evergreen rollover right. Northwest states that establishing a competitive bidding requirement will provide Northwest an opportunity to solicit firm contract commitments for longer primary terms, but with the same rollover rights.

Notice and Interventions

16. Public notice of Northwest's filing was issued on April 28, 2005, with protests due as provided in section 154.210 of the Commission's regulations (18 C.F.R. § 154.210 (2004)). The timely motions to intervene are granted pursuant to Rule 214 of the Commission's Rules of Practice (18 C.F.R. § 385.214 (2004)). Any motions to intervene out-of-time filed before the date of this order are granted pursuant to 18 C.F.R. § 385.214(d) (2004), since the Commission finds that granting intervention at this stage of the proceeding will not disrupt this proceeding or place additional burdens on existing parties. Protests were filed by Occidental Energy Marketing, Inc. (OEMI), DETM, and Duke Energy Marketing America, L.L.C (DEMA), Northwest Industrial Gas Users (NWIGU), and BP Energy Company (BP).

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[15] *Citing Regulation of Short Term Natural Gas Transportation Services, and Regulation of Interstate Natural Gas Transportation Services,* Docket No. RM98-10-012, *Order on Rehearing and Clarification,* 106 FERC ¶ 61,088 at P 17 (2004).

[16] Order No. 636-A, *FERC Stats. & Regs.*, ¶ 30,940 at 30,630 (1992).

17. DETM and DEMA protests Northwest's proposal to eliminate the choice of releasing shippers to make a direct exit fee payment to Northwest instead of the replacement shipper. They suggest that payment of an exit fee directly to Northwest should remain an option under Northwest's tariff. DETM and DEMA also object to Northwest's new tariff provision in GT&C section 22.5 that would allow Northwest to deny permanent releases in instances where Northwest "has a reasonable basis to conclude that it will not be financially indifferent to the release." DETM and DEMA assert that this proposed tariff language is too broad and lacks any objective criteria that shippers could use to mount a challenge to a decision by Northwest to deny a permanent release transaction. All four protestants request that the Commission reject Northwest's proposal in section 22.5(a)(ii) which requires that pre-arranged maximum rate capacity release transactions be subject to competitive bidding based on the length of the contract. They assert that Northwest's proposal is contrary to Commission policy and regulations.

Discussion

18. In Order No. 636, the Commission adopted a capacity release program to allow firm capacity holders to permanently or temporarily release some or all of their capacity through the pipeline to be reassigned to persons acquiring the capacity. The purpose of a capacity release mechanism is to allow for the release of unneeded interstate transportation capacity, promote pre-arranged transactions to meet market needs, and place the interstate transportation capacity in the hands of the replacement shipper who puts the most value on the capacity. We find that Northwest's proposal, with one exception, is consistent with our capacity release program and orders that allow a shipper to sell its capacity and exit the gas marketing business in an orderly fashion.[17]

19. Under Northwest's proposed exit fee option involving a reverse auction, the releasing shipper would pay the exit fee directly to the replacement shipper. DETM and DEMA do not oppose paying an exit fee directly to a replacement shipper as part of a "reverse auction" capacity release transaction. They assert that reverse auction postings can be a viable way to release capacity, and in fact, DETM itself recently completed a portfolio release of its Northwest transportation and supply assets employing this sort of exit fee payment method under such a reverse-auction posting. However, they protest Northwest's proposal to eliminate the choice of releasing

[17] *See e.g., Northwest Pipeline Corporation, Duke Energy Trading and Marketing, L.L.C.*, 109 FERC ¶ 61,044 (2004) (granting tariff waivers to permit the permanent release of temporary capacity release replacement contract or contracts encumbered with temporary releases of their underlying contracts; and to permit a reverse auction bidding process).

shippers to make a direct exit fee payment to Northwest instead of the replacement shipper. DETM and DEMA ask the Commission to accept Northwest's exit fee proposal only as a second payment option to Northwest's currently effective exit fee payment method.

20. DETM states that its experience in its recent portfolio release demonstrates that the option of paying an exit fee directly to Northwest serves a valuable role in a releasing shipper's exit-fee negotiation with potential prearranged shippers: this option acts as a competitive check against demands for excessive exit fees by these prearranged shippers. DETM submits that eliminating the option of paying Northwest an exit fee will therefore result in more contentious and less productive negotiations with prearranged shippers and could impair the efficient functioning of the secondary market.

21. We deny DETM and DEMA's protest. DETM and DEMA wants Northwest's exit fee proposal to be accepted only as a second payment option to Northwest's currently effective exit fee payment method. Under the existing method, a releasing shipper would pay a lump-sum exit fee directly to Northwest equal to the net present value difference between the released contract and replacement contract. One of the reasons Northwest gives as to why payment of exit fees should be made directly to the replacement shipper is to avoid getting entangled in disputes between the parties as to, for example, the discount factor to be used for the net present valuable calculations, as well as administrative and accounting burdens and potential implications relating to rate discounts.[18] DETM and DEMA appear to want Northwest involved in these "potentially prearranged" transactions to assist in the negotiations so that presumably the releasing shippers can secure a better deal (*i.e.*, a lower exit fee) with the prearranged replacement shipper.

22. We do not find that Northwest needs to assume the role of negotiator in the "potentially prearranged" transactions that DETM and DEMA refer to. For one thing, pre-arranged transactions are matters for the parties to the transactions—that is, the releasing and replacement shippers -- to negotiate. Secondly, under Northwest's proposal, releasing shippers can still negotiate exit fee payments directly with replacement shippers, and then post capacity subject to a reverse auction, where other potential shippers bid lower exit fee amounts. Thus, we do not see how DETM and DEMA are harmed by Northwest's proposal *vis-à-vis* Northwest's existing exit fee mechanism. A releasing shipper can always opt to include an exit fee in its release offer and the amount of the exit fee would be established through a straightforward

[18] Under Northwest's proposal, the cash flow discount factor will be the latest annual interest rate published quarterly by the Commission as posted on the Commission's Internet Website, unless specified by the Releasing Shipper.

bidding process. Further, Northwest's proposal is also administratively simpler; Northwest would no longer need to collect and account for potential exit fees. We find Northwest's revised procedures for exit fees on its system are reasonable and consistent with the Commission's capacity release policy, and therefore, DETM and DETA's protests are rejected.

23. Under revised section 22.5(a)(i), Northwest proposes this new provision: "In any event, Transporter may refuse to allow a permanent release if it has a reasonable basis to conclude that it will not be financially indifferent to the release." DETM and DEMA complain that this language is unnecessary in light of Northwest's existing GT&C section 22.5(a)(ii).[19] Moreover, DETM and DEMA assert that that this provision is too broad and lacks any objective parameters that shippers could use to mount an effective challenge to a decision by Northwest to deny a permanent release transaction. As such, they find the proposed language is overly susceptible to abuse in its application and could even be wielded in a manner inconsistent with the *Texas Eastern* "policy" cited by Northwest.[20]

24. In *Texas Eastern*, the Commission explained that its policy concerning permanent releases did not require that the pipeline relieve the releasing shipper of liability simply because the replacement shipper had paid the maximum rate and contracted for the remaining life of the contract. Rather, the Commission also examines whether it would be reasonable for the pipeline to do so given the circumstances before it. The Commission found that, based on the facts presented by Texas Eastern, there was reasonable concern the replacement shipper would default on its contract and, thus, Texas Eastern would not expect to receive the same revenue subsequent to the release.[21] Under those circumstances, the Commission stated that

[19] Under Northwest's existing tariff, section 22.5(a)(ii) would require exit fees but only to the extent necessary to fully compensate Transporter if the accepted bid price and/or contract term of the replacement Service Agreement would require Transporter to forego future revenues. The exit fee would not apply if the accepted bid price the Replacement Shipper or Prearranged Replacement Shipper is to pay is equivalent to or higher than the value of the charges the Releasing Shipper is obligated to pay for the releasing shipper.

[20] *See Texas Eastern, supra,* at 61,445-46 (1998).

[21] *Id.*

the pipeline would have a reasonable basis to refuse to relieve the releasing shipper of liability. As the Commission specifically noted, "given the facts and statements, Texas Eastern would not be financially indifferent" to the proposed transfer of liability to [the acquiring shipper]. [22]

25. The Commission explained that it did not have a bright line policy under which the pipeline would be deemed to be acting unreasonably if it failed to discharge liability for a shipper releasing capacity for the maximum rate and the remaining term of the contract. The Commission stated that "all factors, such as the financial indifference of the pipeline, on a reasonable basis is a necessary and proper manner in which to evaluate whether the pipeline must relieve the releasing shipper from liability".[23] Moreover, the Commission intended that that the pipeline have flexibility in this regard and that not every extenuating circumstance or condition that would define the "reasonable basis" to refuse to relieve the releasing shipper from liability needs to be set out in a pipeline's tariff.[24] Thus,, we do not find that Northwest proposed language is overly broad or lacks any objective parameters. However, as we stated in *Texas Eastern*, the pipeline's discretion must be exercised in a non-discriminatory manner.[25] Further, in order to ensure implementation is non-discriminatory, we find that Northwest must provide written notification and the reasons for any denial of a request for permanent release to the releasing shipper. Northwest is directed to revise its tariff accordingly.

26. Under Northwest's proposed section 22.5(a)(iii), Northwest would subject pre-arranged releases at the maximum rate to competitive bidding. Specifically, the provision provides that if a Prearranged Replacement Shipper has been designated by the Releasing Shipper to acquire permanently released capacity at the maximum rate for the remainder of its contract term, Northwest will solicit competing maximum rate bids for longer terms, limited only by the availability of capacity. All four protestants challenged this aspect of Northwest's filing. They state that Northwest's proposed section 22.5(a)(iii) should be rejected outright since it is inconsistent with the Commission's regulations with regard to the exemption from the posting and bidding requirements for pre-arranged releases of capacity at the maximum rate. Moreover, they assert, Northwest's reliance on a Commission order issued under delegated authority that authorized Gulf South to post maximum rate service requests for competitive bidding based on term is misplaced. They state that Gulf South's filing

[22] *Id.* at 61,446.

[23] *Id.* at 61,448.

[24] *Id.* at 61,449.

[25] *Id.* at 61,447.

did not relate to capacity release transactions, but rather to the request for firm transportation service from Gulf South. Further,, the protestants assert that pre-arranged deals are an important feature of the current secondary market, and the Commission should not permit Northwest to disrupt them. They contend that Northwest's proposal would also undermine the rights of firm shippers who wish to release their capacity while allowing the pipeline to try to improve upon contract terms to which it has already agreed. OEMI contends Northwest's proposal would have a chilling effect on pre-arranged releases.

27. We agree that Northwest's proposal to subject pre-arranged permanent capacity releases at the maximum rate to competitive bidding based on term is not consistent with our regulations. Section 284.8(h)(1) of the Commission's regulations states: "[a] release of capacity by a firm shipper . . . . for any term at the maximum rate applicable to the release need not comply with the notification and bidding requirements of . . . . this section."[26] Also, the Commission's *Gulf South* order that Northwest relies on was issued under delegated authority. An order issued under delegated authority is binding on the parties to that proceeding, but its precedential value beyond that proceeding is limited.[27] Further, in the *Gulf South* proceeding, Gulf South did not seek to subject capacity releases at the maximum rate to competitive bidding so the case is not on point.

28. Northwest states that on its system all but one existing maximum rate long-term shipper has evergreen rights, and in most cases only the shipper has the right to provide the termination notice. Northwest states that while it has to guarantee capacity in perpetuity, a maximum rate shipper could permanently release its contract to a pre-arranged term for the remaining primary term. We agree with the protestants that Northwest agreed to the original firm contract, including the contract term with evergreen rights, and it should be held to its end of the bargain. Moreover, pre-arranged deals are a standard fixture in the marketplace and provide valuable benefits, including contract certainty and reliability, to market participants. Northwest is attempting to boot strap contract extensions into a process designed to allow shippers to release their capacity. The two are unrelated. It is also inconsistent for Northwest to desire to be removed from any exit fee related to contract termination, only to re-insert itself into the process where it sees a potential advantage. Further, Northwest would be no worse off under the pre-arranged permanent capacity release than it would have had the contract not been released. Northwest has not presented us with any arguments that would persuade us to grant Northwest an exemption from our capacity release policy and regulations which provide that pre-arranged capacity

[26] 18 C.F.R. § 284.8(h)(1) (2005).

[27] *See Tennessee Gas Pipeline Company*, 111 FERC ¶ 61, 094 at P 22 (2005).

releases at the maximum rate need not be subject to the bidding requirements under section 284.8 of the Commission's regulations. Thus, we direct Northwest to remove proposed section 22.5(a)(iii) from its tariff.

<u>The Commission orders:</u>

(A) Northwest's tariff sheets listed in footnote no. 1 are accepted, effective May 23, 2005, subject to the conditions discussed in the body of this order.

(B) Northwest is required to file revised tariff sheets within 30 days of the date of this order.

By the Commission.

(S E A L)

Linda Mitry,
Deputy Secretary.