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.

Northern Natural Gas Company Docket No. RP06-339-002

ORDER ON REHEARING

(Issued January 26, 2007)

1. On June 28, 2006 the Northern Municipal Distributors Group (NMDG) and the Midwest Region Gas Task Force Association (MRGTF) (collectively, Distributors)[1] filed a request for rehearing of the Commission's May 30, 2006 Order[2] in the captioned proceeding. The May 30 Order accepted a non-conforming discounted rate agreement filed by Northern Natural Gas Company (Northern) with Flint Hills Resources, L.P. (Flint Hills). The Commission also accepted a tariff sheet filed by Northern to add the subject agreement to its list of non-conforming service agreements, to be effective June 1, 2006. As discussed below, the Commission denies the request for rehearing of the May 30 Order.

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[1] NMDG is composed of the following Iowa municipal-distributor customers of Northern Natural Gas Company: Cascade, Cedar Falls; Coon Rapids; Emmetsburg; Gilmore City; Graettinger; Guthrie Center, Harlan; Hawarden; Lake Park; Manilla; Manning; Osage; Preston; Remsen; Rock Rapids; Rolfe; Sabula; Sac City; Sanborn; Sioux Center; Tipton; Waukee; West Bend; Whittemore; and Woodbine. MRGTF is composed of the following municipal-distributor and local distribution customers of Northern Natural Gas Company: Austin; Circle Pines; Community Utility Company; City of Duluth, Minnesota - Duluth Public Utilities; Great Plains Natural Gas Company; Hibbing; Hutchinson; New Ulm; Northwest Natural Gas Company; Owatonna; Round Lake; Sheehan's Gas Company, Inc.; Two Harbors; Virginia; and Westbrook, Minnesota; Midwest Natural Gas, Inc.; Superior Water Light & Power; St. Croix Valley Natural Gas, Wisconsin, d/b/a St. Croix Gas, Wisconsin; and Watertown, South Dakota.

[2] *Northern Natural Gas Co.*, 115 FERC ¶ 61,270 (2006) (May 30 Order).

I. **Background**

2. In the May 1, 2006 filing (May 1 filing) at issue here, Northern filed a non-conforming discounted rate agreement for service (Amendment No. 2) with Flint Hills. The agreement provided that Northern would transport up to 102,000 Dth per day for Flint Hills under Rate Schedule TFX. The agreement provided a discounted rate of $0.155 per Dth (combined demand and reservation charge) for the first 75,000 Dth per day, and $0.100 per Dth (combined reservation and demand charge) for any volumes above 75,000 Dth.

3. Northern stated that the discounted rate agreement contains two non-conforming provisions: 1) a provision that would allow Northern and Flint Hills to renegotiate the terms of the agreement should the Commission require any change to the proposed agreement or to Northern's tariff and 2) a provision stating that "[Flint Hills] agrees to support Northern's proposed transportation rates provided herein as being necessary to retain its load on Northern's system." Northern asserted that these provisions do not affect the quality of service to Flint Hills and should not be of any interest to other customers.

4. On May 30, 2006, the Commission accepted the non-conforming discounted rate agreement between Northern and Flint Hills, which went into effect on June 1, 2006, to terminate on March 31, 2011. The Commission also accepted Northern's proposed tariff sheet to add the subject agreement to its list of non-conforming service agreements. On June 28, 2006, Distributors filed a request for rehearing of the Commission's May 30 Order.

5. On rehearing, Distributors raise numerous concerns with Northern's agreement, many of which were previously raised in other recent Northern non-conforming service agreement filings.[3] Distributors claim that Northern's May 1 filing is inadequate because it does not comply with the Commission's filing requirements, fails to explain how the

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[3] *Northern Natural Gas Co.*, 111 FERC ¶ 61,287 (2005) (*MUD I*), *order on reh'g* 113 FERC ¶ 61,119 (2005) (*MUD II*); *Northern Natural Gas Co.*, 110 FERC ¶ 61,321 (2005) (*Centerpoint I*), *order on reh'g*, 111 FERC ¶ 61,379 (2005) (*Centerpoint II*), *order on reh'g,* 113 FERC ¶61,188 (2005) (*Centerpoint III*), *appeal pending*, *Northern Mun. Distribs. Group and Midwest Gas Task Force Ass'n v. FERC*, (D.C. Cir.), Case Nos. 05-1468 and 06-1016; *Northern Natural Gas Co.*, 115 FERC ¶ 61,146 (2006) (NSP-MN Order).

currently-existing Right of First Refusal (ROFR) and rollover rights have been exercised to achieve the new Discounted Agreement, and fails to support its claim of a bona fide threat of bypass by Flint Hills.

6. Distributors argue that the Commission, in its May 30 Order, did not address the fundamental issues of whether Northern's discounts to Flint Hills foster unlawful discrimination or an abuse of market power, grant undue preferences, and/or condone anti-competitive behavior. Distributors contend that, under the circumstances presented in this case, the Commission should exercise its section 4 and 5 powers under the Natural Gas Act (NGA) now to address these issues and investigate the impact of the discounted agreement on captive and other shippers. Further, Distributors argue that the Commission erred in failing to require Northern to post the capacity subject to the discounted agreement to allow other shippers to bid on that capacity. Finally, Distributors argue that the Selective Discounting Policy[4] does not provide adequate protections to consumers under the circumstances presented here, claiming that Northern can easily shift the initial and heaviest burden of proof to those parties challenging the discount. Distributors add that the Selective Discounting Policy, as a statement of policy, is not a binding rule and its use must be justified in the particular circumstances of each case. Distributors request that the Commission either reject the May 1 filing or set these issues for technical conference and formal hearing, including discovery.

II. Discussion

7. For the reasons discussed below, the Commission denies rehearing on all issues.

A. Impact of the Discounted Agreement on Captive and Other Shippers

8. In accepting Northern's filing, the May 30 Order noted that Distributors have raised similar concerns about non-conforming discounted rate agreements with other major customers on Northern's system, including CenterPoint Energy Minnesota Gas (CenterPoint) and Metropolitan Utilities District (MUD), in what Northern stated was an attempt to keep those entities from bypassing its system.[5] In both the Centerpoint and

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[4] Distributors cite *Policy For Selective Discounting By Natural Gas Pipelines,* 111 FERC ¶ 61,309 (2005) (*Selective Discounting Policy), order on reh'g,* 113 FERC ¶ 61,173 (2005) (*Selective Discounting Policy II*), *appeal pending sub. nom.* IMGA v. *FERC*, (D.C.Cir. Case No. 06-1006).

[5] *MUD I*, 111 FERC ¶ 61,287; *MUD II*, 113 FERC ¶ 61,119; *Centerpoint I*, 110 FERC ¶ 61,321; *Centerpoint II*, 111 FERC ¶ 61,379; *Centerpoint III*, 113 FERC ¶ 61,188, *appeal pending, Northern Mun. Distribs. Group and Midwest Gas Task Force Ass'n v. FERC,* (D.C. Cir.), Case Nos. 05-1468 and 06-1016.

MUD proceedings, the Commission denied objections similar to those raised in the instant proceeding by Distributors. As discussed below, the Commission, for the reasons generally espoused in those orders, will again deny the arguments raised by Distributors.

9. First, Distributors argue that the anti-competitive and discriminatory aspects of Northern's filing should be addressed now rather than later. Distributors argue that under the NGA, the Commission has the responsibility of ensuring that pipelines do not engage in undue discrimination among their customers.[6] Distributors' primary claim is that they will be required to bear the costs of the Flint Hills discounts in Northern's next rate case. Distributors argue that the Commission must define now the extent to which captive and other shippers will be required to subsidize the discounts provided to Flint Hills.

10. Distributors argue that as more individual contracts are executed, there are fewer shippers that pay the maximum rate. They state that the maximum rates are driven higher as the pipeline continues to recover the discounts and other benefits provided to favored shippers through devices such as selective discounting adjustments. Distributors argue that *Maryland Peoples Counsel v. FERC*, 761 F.2d 780 (D.C. Cir. 1985) (*MPC II*) clearly prohibits such results. Distributors argue that similar to the situation in *MPC II*, the Commission here avoided consideration of the discount and benefit issues and the related discrimination, preference, as well as market and monopoly power issues – failing to examine them in detail or explain why Distributors' fears concerning these issues can realistically and effectively be addressed at some later date.

11. The Commission rejects these contentions. In Order No. 436, which, in part, was a response to the judicial mandate of *MPC II*, the Commission adopted regulations permitting pipelines to engage in selective discounting based on the varying demand elasticities of the pipeline's customers.[7] Specifically, the Commission adopted regulations requiring pipelines to file maximum and minimum transportation rates for both firm and interruptible service and to charge rates to customers within the maximum

[6] Distributors' Rehearing Request at 13, *citing*, *ANR Pipeline Co.*, 98 FERC ¶ 61,181, at 61,669 (2002).

[7] *See Regulations of Natural Gas Pipelines After Partial Wellhead Decontrol,* Order No. 436, FERC Stats. & Regs., Regulations Preambles (1982-1985) ¶ 30,665, at 31,543-45 (1985).

and minimum range.[8] These regulations permit a pipeline to discount its rates, on a not unduly discriminatory basis, in order to meet competition. In Order No. 436, the Commission explained that selective discounts would benefit all customers, including customers that did not receive the discounts, because the discounts would allow the pipeline to maximize throughput and thus spread its fixed costs across more units of service. The Commission further stated that selective discounting would protect captive customers from rate increases that would otherwise ultimately occur if pipelines lost volumes through the inability to respond to competition.

12. In *Associated Gas Distributors v. FERC (AGD I)*,[9] the court upheld these selective discounting regulations. The court found that, as a general matter, the Commission could permit pipelines to offer differing discounts depending upon the differing demand characteristics of their customers. The court agreed that such discounts could benefit captive customers by enabling pipelines to obtain demand elastic customers who would "mak[e] a contribution to fixed costs that otherwise would not be made at all."[10]

13. In the 1989 Rate Design Policy Statement,[11] the Commission adopted a rate design methodology that would prevent the subsidization of discounts by non-discounted customers and also achieve the goal set forth by Order No. 436 of maximizing throughput. Thus, the Commission held that if a pipeline grants a discount in order to meet competition, the pipeline is not required in its next rate case to design its rates based on the assumption that the discounted volumes would flow at the maximum rate, but may reduce the discounted volumes so that the pipeline will be able to recover its cost of service. The Commission explained that if a pipeline must assume that the previously discounted service will be priced at the maximum rate when it files a new rate case, there may be a disincentive to pipelines discounting their services in the future to capture marginal firm and interruptible business. This policy of permitting discount adjustments

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[8] 18 C.F.R. § 284.10 (2006). Section 284.10(c)(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 just and reasonable maximum rate and a minimum rate for each service. Thus, the Commission has already authorized the subject discounts through its Part 284 regulations and its approval of Northern's tariff.

[9] 824 F.2d 981, 1010-12 (D.C. Cir. 1987).

[10] *Id. at* 1011.

[11] *Policy Statement Providing Guidance With Respect to the Designing of Rates*, 47 FERC ¶ 61,295, *order on reh'g*, 48 FERC ¶ 61,122 (1989) (1989 Rate Design Policy Statement).

is consistent with the discussion of the court in *AGD I* suggesting that discount adjustments should be permitted.[12] Further, the Commission recently reaffirmed its policies concerning its selective discounting program and concluded that it would not modify them.[13]

14. As discussed below, 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.

15. Further, Distributors misapply *MPC II*. In *MPC II*, 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.[14] However, the instant case does not involve a situation

[12] On rehearing of the 1989 Rate Design Policy Statement, the Commission rejected contentions that it 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. Further, the Commission reasoned 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. 48 FERC at 61,449.

[13] *Policy For Selective Discounting By Natural Gas Pipelines*, 109 FERC ¶ 61,202 (2004) (*Selective Discounting Order*); *Selective Discounting Policy*, 111 FERC ¶ 61,309; *Selective Discounting Policy II*, 113 FERC ¶ 61,173.

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

where the Commission is permitting a pipeline to deny a service to some customers while providing the same service to other customers. Here, consistent with its policies, the Commission is permitting Northern to offer different rates to different customers depending upon their different elasticities of demand. Further, in *AGD I*, the court held that to read *MPC II* 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." [15]

16. Distributors argue that while the Commission's discount adjustment policies may be appropriate in a variety of normal circumstances, in the instant case, because the discounts are substantial and because Northern, by settlement agreement, cannot file another rate case with rates to be effective prior to November 1, 2007, such policies cannot be justified here.[16]

17. The Commission has pointed out that its regulations permit pipelines to offer selective discounts to shippers based on their varying elasticities of demand, and that this has been affirmed by the court. The Commission has also stated that it need not further examine the proposed discounts in the proceeding before it because Part 284 of its regulations expressly permit 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."[17] Since Northern's tariff sets forth both a maximum and minimum rate for each service, the discounted rates that Northern proposes are not deviations from Northern's tariff, which required Commission approval. Therefore, the Commission has already authorized the discounts through its Part 284 regulations and its approval of Northern's tariff.

18. As set forth in previous Northern Natural orders,[18] the Commission will not predetermine whether it will permit Northern, in its next NGA section 4 general rate case,

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

[16] Distributors argue that since a statement of policy – such as the Selective Discounting Policy – is not a binding rule, its use must be justified in the particular circumstances of each case, citing *Pacific Gas and Electric Co. v. FPC,* 506 F.2d 33, 38 (D.C. Cir. 1974). For the reasons discussed throughout this order, the Commission finds that its discounting policy is appropriately applied in this case.

[17] 18 CFR § 284.10(c)(5)(ii)(A) (2006).

[18] *MUD II*, 113 FERC at P 31-32; *CenterPoint III*, 113 FERC at P 25-28.

to reduce its rate design volumes to account for the instant discounts.[19] The same rationale applies in the instant case. It is well established that the Commission may order proceedings in the manner it determines is most efficient.[20] In their rehearing request, Distributors do not allege that Northern's contracts with Flint Hills cause them any current harm. The discount in the subject agreement has no effect on the rates that Distributors or any other customer other than the discounted customer currently pays.[21]

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[19] As the Commission has recently stated:

> Therefore, the Commission reaffirms its conclusion that discounts given by competing pipelines provide sufficient public benefits that we will not modify our policy to adopt a blanket prohibition on adjustments to rate design volumes to reflect such discounts. As we stated in the May 31 Order, if there are circumstances on a particular pipeline that warrant additional protections for captive customers, including a limitation on the discount adjustment to rate design volumes, those issues can be considered in individual rate cases. 113 FERC ¶ 61,173 at P 53.

[20] *See Stowers Oil and Gas Co*., 27 FERC ¶ 61,001 (1984) and cases cited therein.

[21] In the *Selective Discounting Policy*, 111 FERC ¶ 61,309, the Commission addressed arguments similar to the situation presented here. In sum, customers argued that they were harmed because discounts resulted in increased rates for them. Distributors, referred to as Northern Municipals in the order, presented an example involving Northern giving a large discount to an existing customer, Centerpoint, to prevent it from taking its business to a new intrastate pipeline. Distributors asserted that these discounted rates would be in effect until 2019 and that Northern would attempt to recover this discount from its captive shippers. Distributors stated that no significant additional volumes would flow as a result of the discount. Moreover, they argued that, under its current policy, Northern did not have the burden of proof to show that the discounts were either necessary or reasonable. The Commission stated:

> [Distributors] does not allege that any harm has occurred to them as yet, but anticipates that the harm will occur when Northern seeks a discount adjustment in its next rate case. This harm is therefore speculative. Further, [Distributors'] statement that Northern has no obligation to show that the discounts were necessary or reasonable is not accurate. Northern has the ultimate burden of showing that this long-term discount was in fact necessary to meet competition. Further, the Commission has the obligation to assure that rates to all customers are just and reasonable and can consider mitigating measures where the rate impact on captive customers is inequitable. The circumstances described by [Distributors] do not warrant

(continued…)

19. Northern's maximum rates will remain those approved in its last general section 4 rate case, until such time as Northern proposes to change them in a new section 4 filing.[22] The record in Northern's last section 4 rate case did not, and could not, reflect the discounts Northern is providing in the instant agreements. Therefore, those rates do not include any discount adjustment with respect to the instant agreements. Since "[T]he pipeline is at risk for service provided at prices below those projected in the setting of its rates," [23] at least until Northern's next rate case, its other customers can in no way be considered to be subsidizing the discounts given to the discounted customer.[24] Moreover, as set forth below, because all parties will have an opportunity to contest any request for a discount adjustment to Northern's throughput in any future rate case where rates to non-discounted customers may change, nothing raised here compels the Commission to deviate from its current selective discounting policies.

20. Therefore, as the Commission has set forth the standards for discount adjustments, we will reject the arguments proffered by Distributors.

B. Filing requirements

21. In its protest to Northern's filing, Distributors argued that Northern had failed to comply with the requirements of sections 154.204 and 154.600 of the Commission's regulations, which require that a filing addressing service agreements must include, among other things, a description of the necessity for the changes being proposed. Distributors assert that section 154.204(d) provides:

> the Commission's abandoning its selective discount policy that has provided substantial competitive benefits to a large number of shippers on the national grid. 111 FERC ¶ 61,309 at P 54.

[22] *MUD II*, 113 FERC ¶ 61,119 at P 26-28 (setting forth various reasons why the Commission will examine the need for a discount adjustment to throughput only in a subsequent rate case).

[23] *Id.* at P 26, *citing*, 48 FERC ¶ 61,122 at 61,449.

[24] Further, as the Commission stated in the *Selective Discounting Policy*:

> Moreover, a hearing in a rate case gives all the parties an opportunity to seek discovery regarding the purpose and level of any discount. Therefore, Commission Staff and other parties can use this opportunity to seek an explanation of each discount, and if the pipeline cannot support any discount, this issue can be raised at the hearing. 111 FERC ¶ 61,309, at P 62 (2005).

> A filing to revise rate schedules, forms of service agreements, or the general terms and conditions, must: . . . (d) Explain the impact of the proposed revision on firm and interruptible customers, including any changes in a customer's rights to capacity in the manner in which a customer is able to use such capacity, receipt or delivery point flexibility, nominating and scheduling, curtailment, capacity release . . .

22. The May 30 Order held that Northern had filed adequate information, including the actual non-conforming discount provision with Flint Hills. The Commission stated that this provided sufficient information to judge the proposal on its merits without the need for additional information.

23. On rehearing, Distributors point out that, in an earlier May 5, 2006 Order accepting Northern Natural's filing of similar nonconforming agreements with Northern States Power Company-Minnesota (NSP-MN), the Commission held that section 154.204 is not applicable to the filing of nonconforming agreements, because the regulation relates only to tariff filings to revise rate schedules, form of service agreements in the pipeline's tariff, or the pipeline's general terms and conditions of service, which nonconforming agreements do not do.[25]

24. Distributors interpret the May 30 Order in this proceeding as having conceded, contrary to the holding in the May 5 Order accepting the NSP-MN agreements, that section 154.204(d) is applicable to Northern's filing of the nonconforming Flint Hills agreement, because the May 30 Order contains no explicit holding that section 154.204(d) is not applicable. In any event, Distributors argue, the earlier May 5 Order erred in finding that section 154.204(d) is not applicable to the filing of non-conforming agreements. Distributors point out that, while section 154.204 refers to rate schedules, forms of service agreements, and terms and conditions, 18 C.F.R.§ 154.600 requires that a pipeline filing any proposal to implement a tariff change other than a change in rate level must comply with subparts A, B, and C of Part 154. Since section 154.204 is included in subpart C, section 154.600 allegedly imposes its requirements on the filing of tariff changes to list nonconforming agreements. Therefore, Distributors argue that Northern's filing, which includes a tariff change proposal to reflect the Flint Hills agreement as a non-conforming agreement, is subject to these provisions. Distributors further contend that Northern failed to include sufficient information with its filing to satisfy the requirements of section 154.204(d).

25. The Commission finds that the filing requirements contained in section 154.204(d) do not apply to Northern's filing of non-conforming contracts, such as the contract at

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[25] 115 FERC ¶ 61,146 at P 8.

issue here. The general requirement in section 154.600 that any proposed tariff change other than in rate level must comply with subparts A, B, and C of Part 154 was not intended to impose on all filings the requirements of subparts A, B, and C, which expressly apply only to specific types of filings. Section 154.204 itself provides in subparagraph (a) that a filing to revise rate schedules, forms of service agreements, or the general terms and conditions must "adhere to the requirements of subparts A, B, and C of this Part." Sections 154.204(b) through (f) then go on to list the specific filing requirements for filings to revise rate schedules, forms of service agreements, or general terms and conditions. Thus, none of those requirements apply to the instant filing of non-conforming service agreements.

26. In any event, the Commission finds that Northern has presented the information necessary to meet the filing requirements for its proposal. Northern filed its non-conforming discounted rate agreement with Flint Hills, together with First Revised Sheet No. 66D to its FERC Gas Tariff, Fifth Revised Volume No. 1, to add the agreement with Flint Hills to its tariff list of non-conforming agreements. In its filing, Northern stated that the agreement includes two non-conforming provisions: (1) a renegotiation provision and (2) a provision stating that Flint Hills agrees to support Northern's proposed transportation rates as being necessary to retain its load on Northern's system. Both in its filing and its May 19 answer, Northern explained how the Commission had previously approved these types of provisions as being "sufficiently connected to the proposed rates that they do not present a substantial risk of undue discrimination . . . and do not affect the quality of service provided."[26] Northern went on to explain how these provisions do not affect the quality of service to Flint Hills, nor should they be of any interest to other customers. Northern also stated that the Commission had previously approved a nonconforming provision similar to the provision in the Flint Hills contract stating that Flint Hills will support Northern's rates as necessary to retain its load. Northern stated that it had negotiated such a provision with NSP-MN, and the Commission had found that provision to be permissible since it did not affect the quality of service Northern provides to its other shippers.[27]

27. The Commission finds that the above information was sufficient to meet the filing requirements for filing the instant non-conforming agreement and for the Commission to find that the nonconforming provisions do not present a substantial risk of undue discrimination and do not affect the quality of service provided to any customer. Distributors have made no argument that these specific nonconforming provisions will adversely affect their service or otherwise harm them. Their concern is over the

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[26] May 1 filing at 2, *citing Northern Natural Gas Co.*, 110 FERC ¶ 61,321, at P 12 (2005).

[27] 115 FERC ¶ 61,146 at P 16.

discounted rate, and not the nonconforming provisions. Thus, the information that Distributors claim Northern failed to provide all goes to the issue of whether Northern needed to provide a discount to keep Flint Hills on its system or, alternatively, could have obtained a higher rate from another shipper. For example, Distributors contend that, while one of the nonconforming provisions requires Flint Hills to support the discounted rate in the agreement as necessary to retain its load, Northern provided no information to show that there was any *bona fide*, viable threat of a bypass by Flint Hills. Distributors state that Northern provided no information that Flint Hills sought to bypass Northern by having discussions with any other intrastate or interstate pipeline. Distributors also assert that at the same time Northern negotiated the instant discounted rate it was soliciting interest in the construction of facilities to expand its pipeline. Distributors contend that this suggests that if Flint Hills had left the system, Northern could have sold its capacity at a higher rate than the discounted rate agreed to with Flint Hills.

28. As already explained above, the purpose of the instant filing was solely to obtain approval for the non-conforming provisions of the contracts, and not the discounted rate.[28] As a result, there was no need for Northern to provide in this filing any support for the need to offer the discounted rates included in the contract. Thus, evidence as to whether Flint Hills had a *bona fide* opportunity to bypass Northern's system or Northern could have sold Flint Hills' capacity at a higher rate to a different shipper is not relevant to determining whether the nonconforming provisions should be approved. Such evidence would only be relevant to the issue of whether Northern may be entitled to a discount adjustment in connection with the instant agreement. As discussed elsewhere in this order, that issue may be addressed in Northern's next rate case, but not in the instant case.

29. Distributors also argue that Northern improperly provided only the new agreement with Flint Hills, without filing the superseded agreements, making it impossible to determine what has changed. However, since Northern never filed its previous agreements with Flint Hills as nonconforming, they presumably followed the form of service agreement in Northern's tariff. Thus, apart from the rate, what has changed is the addition of the nonconforming provisions, and, as already discussed, those provisions are permissible. In any event, since Northern is not asking for approval of any of the superseded agreements, we determine that the filing of the superseded agreements to demonstrate the change from one contract period to another is irrelevant as to whether the nonconforming provisions in the instant agreement are acceptable.

30. Finally, Distributors request that, should the May 1 filing not be rejected, the Commission establish a technical conference and evidentiary proceedings now to determine whether and to what extent Northern will be permitted to recover these

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[28] 115 FERC ¶ 61,270 at P 7.

discounts from its remaining customers and to address the other issues raised by Distributors. The Commission rejects these requests, since the Commission has held that it will not address these issues in this proceeding.

31. Therefore, the Commission denies rehearing on this issue.

C. Burden of Proof

32. Distributors also argue that discount and other issues cannot be left for determination until after November 1, 2007, when any rates resulting from a section 4 rate case can first become effective, because competitive alternatives will no longer be available to Flint Hills and because attempts to delve into Northern's reasons for providing these discounts and benefits will be almost surely labeled as "twenty-twenty hindsight." Moreover, Distributors argue that if Northern continues to grant such discounts and benefits to its customers, the only shippers that will be left to address the appropriate level of maximum rates on Northern's system in a future rate case will be those without such benefits and discounts and least able to bear the burden of responding to the pipeline's rate case.

33. Distributors argue that at some point Northern will most likely claim that it is entitled to a discount adjustment, and that Distributors and others will be left to argue that the discount adjustment should be disallowed. Moreover, Distributors argue that by the time the discount adjustments must be justified, personnel will have changed, records will have been lost or misplaced, and memories will have faded, leaving Distributors with an impossible task.

34. Distributors argue that, under the *Selective Discounting Policy,* Northern need only claim that the discount was given to meet competition to shift the initial, and heaviest, burden of going forward with evidence to those parties challenging the discount. Discounters claim that it, along with other parties, are placed in the untenable position of having to "go first" and to produce evidence that the discounts provided to Flint Hills were not justified by competitive considerations.

35. The Commission has addressed Distributors' arguments regarding the burden of proof necessary for a pipeline to obtain a discount adjustment to throughput in a future rate case in several recent orders.[29] These cases set forth the Commission's position regarding the burden of proof necessary for a pipeline to obtain a throughput adjustment

[29] *Centerpoint II,* 111 FERC ¶ 61,379 at P 18-19; *Centerpoint III,* 113 FERC ¶ 61,188 at P 17-19, 22-23, 25; *MUD II,* 113 FERC ¶ 61,119 at P 32-33; *Selective Discounting Policy,* 111 FERC ¶ 61,309 at P 59-66; *Selective Discounting Policy II,* 113 FERC ¶ 61,173 at P 100-108.

for discounts in a subsequent NGA section 4 rate case. In brief, under the Commission's policy, in order to obtain 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, 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.[30] 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 to raise a reasonable question concerning whether competition required the discounts given in particular non-affiliate transactions. Once the party opposing the discount adjustment raises a reasonable question about the circumstances of the discount, then the burden shifts back to the pipeline to show that the questioned discounts were in fact required by competition.

36. In reaffirming its selective discounting policies, the Commission addressed similar arguments by Distributors regarding the burden of proof necessary in discount adjustment proceedings.[31] The Commission stated that:

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[30] As the Commission recently stated:

> The Commission does not require the pipeline to initially present detailed evidence to substantiate that each discount was granted to meet competition because it assumes that, in the case of a discount to a non-affiliate, the pipeline will always seek the highest rate for its services because it is in its own best economic interests to do so. The Commission can make assumptions about rational business behavior and a pipeline, like any other business, can be presumed to act in its own economic best interests. Contrary to the parties' assertions here, the discount adjustment does not negate that assumption. There is no rational reason for a pipeline company to sell capacity at less than the highest rate it can charge. It would not be a good business practice for a pipeline to turn down the opportunity to put money in its pocket today through a higher rate in order to take a chance that the Commission will allow a discount adjustment in a future rate case. *See*, *e.g.*, *Columbia Gas Transmission Corp.*, 848 F.2d 250, 251-54 (1985) (pipeline will seek the highest possible rate). There is no guarantee that the Commission will approve a discount adjustment and the Commission has denied pipelines this rate treatment when it has not been shown that the discounts were required by competition. 113 FERC ¶ 61,173 at P 107.

[31] *Selective Discounting Order*, 109 FERC ¶ 61,202; *Selective Discounting Policy*, 111 FERC ¶ 61,309 at P 65; *Selective Discounting Policy II*, 113 FERC ¶ 61,173 at P 24.

> [Distributors] overstate the burden placed upon parties challenging a discount adjustment. Contrary to the assertions of [Distributors], the burden placed upon the opponents of the discount adjustment is not an unduly heavy burden. All the challenger of a discount adjustment must do, after the pipeline has explained generally the basis for its discounts, is produce some evidence that raises a reasonable question concerning whether the discount was required to meet competition. Thus, [Distributors'] concern that, in a rate case, "the opposing party's attempts to prove that the discounts were not necessary are invariably met with charges that they are using 'twenty-twenty' hindsight to challenge the discounts" is unfounded. Contrary to [Distributors'] assertion, the opponent of the discount is not required to prove that the discount was not given to meet competition, but merely has to raise a reasonable question as to the validity of the discount and the pipeline is required to show that it was made to meet competition. Further, the relevant inquiry is whether at the time the discount was given it was necessary to meet competition and this inquiry would not be dismissed as hindsight. 113 FERC ¶ 61,173 at P 104.

37. The same rationale applies in the instant case. The Commission has also previously addressed Distributors' concern that Distributors will not be able to set forth its case because, by the time the discount adjustments must be justified, personnel will have changed, records will have been lost or misplaced, and memories will have faded, leaving Distributors with an impossible task. The Commission clearly set forth the burden with regard to Distributors' concern stating that:

> It is not an undue burden to ask the parties opposing the discount adjustment to introduce some evidence that raises a question about the need for the discount. In a rate case where the discount adjustment is challenged, all parties have an opportunity to seek discovery of all the facts surrounding each discount. Thus, discovery will provide the parties with the information necessary to determine whether a challenge to a discount adjustment is appropriate and the ultimate burden of proof on the issue will be on the pipeline. In this regard, if a pipeline is unable in response to a discovery request to explain why competition required a particular discount, the Commission would regard that fact alone to raise a sufficient question concerning whether the discount was required to meet competition to shift the burden to the pipeline to justify the discount. Thus, pipelines must keep information relevant to each discount because if they are unable to explain and justify each discount, they will not be able to meet their burden of proof.[32]

[32] 113 FERC ¶ 61,173 at P 105.

38. The Commission also stated that:

> To the extent a pipeline is unable during the discovery process to explain what competitive alternatives the recipient of any particular discount had or otherwise give a satisfactory explanation of why the discount was required, that fact by itself would be sufficient to rebut the presumption that competition required the discount.[33]

39. Therefore, the Commission will deny rehearing on this issue.

D. Right of First Refusal (ROFR) and Rollover Rights

40. In their initial protest, Distributors argued that there was not enough information to determine whether Northern and Flint Hills have complied with (1) the ROFR provisions of the Commission's regulations and Northern's tariff and (2) the grandfathered rollover right provisions in Northern's tariff.

41. In their rehearing request, Distributors claimed that their initial protest raised the issue of whether either of these rights was present in Flint Hill's current contracts with Northern and, if so, whether these rights had been properly exercised in the negotiation and execution of the discounted agreement at issue here. Distributors point out that in the May 30 Order, the Commission stated that section 58 of Northern's tariff allows Northern and a shipper to agree to include ROFR rights in service agreements. The Commission found this provision to be a permissible conforming provision and this right to be available to all shippers on a not unduly discriminatory basis.[34]

42. Distributors assert on rehearing that the Commission failed to address the grandfathered rollover right. Distributors claim that the issue is not whether ROFR provisions could be included in a new contract under the tariff, but whether the discounted agreement is the result of a proper application of the ROFR and the grandfathered rollover rights to Flint Hills' existing agreements. Distributors argue that these contracts apparently contained or were subject to ROFR rights and grandfathered rollover rights with respect to at least some portion of the capacity. Therefore, Distributors question whether those rights were properly exercised, resulting in the discounted agreement at issue here.

43. Distributors further argue that Northern has failed to support its filing by not specifically identifying the entitlement subject to ROFR and/or rollover rights, and not

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[33] *Id.* at P 61.

[34] 115 FERC ¶ 61,270 at P 12.

adequately explaining how the new discounted agreement complies with the various rollover and ROFR requirements.

44. In the instant case, Northern and Flint Hills chose to mutually negotiate modifications in, and extensions of, the existing contracts, rather than to exercise the ROFR or rollover portions of those contracts. This was permissible under Commission policy, and accordingly, whether the parties complied with the ROFR or roll-over provisions is not relevant.

45. 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.[35] In the instant case, Northern has permitted Flint Hills to extend the use of the capacity that it currently holds.[36] At the same time, the ROFR right permits the pipeline an opportunity to test the market value of its capacity. However, the Commission assumes that a pipeline will always seek the highest possible rate from non-affiliated shippers, because it is in the pipeline's own economic interest to do so. This permits pipelines a degree of business judgment regarding the sale of its capacity. If the pipeline is satisfied that its agreements to extend contracts with its existing customer gives it as much revenue as it could expect to obtain through marketing the capacity to third parties, it need not commit the capacity to a bidding process.

46. Northern has permitted Flint Hills to extend the use of the capacity that it currently holds under new terms. In the instant situation, Flint Hills, the existing customer, has agreed to the terms of the new contract and maintained its access to capacity without the need to avail itself of the protections provided by the ROFR process. It does not appear that the shipper had to avail itself of the grandfathered ROFR right process in order to maintain its current capacity. Instead, Flint Hills reached an agreement with Northern to extend its capacity. Therefore, the ROFR process, which is intended to protect an existing shipper from the exercise of a pipeline's monopolistic power, is not violated by this agreement between the shipper and the pipeline. Moreover, no party to the instant proceeding has indicated that it desires the capacity that Northern has permitted Flint Hills to retain at a discounted rate. Neither in their rehearing request nor in their earlier pleadings in this case have Distributors indicated any interest in bidding on the Flint Hills capacity.

47. In regard to rollover rights granted by Northern's tariff, the Commission previously found that such rights were derived from a settlement filed by Northern in

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[35] *See, e.g.*, *MUD II*, 113 FERC ¶ 61,119 at P 44-46 (*citing Transcontinental Gas Pipeline Co.*, 103 FERC ¶ 61,295 at P 3).

[36] *See, e.g.*, *MUD II*, 113 FERC ¶ 61,119 at P 44-46; *CenterPoint II*, 111 FERC ¶ 61,379 at P 41-42.

1993 (*Settlement*).[37] The Commission found that Northern's Settlement states that, should a shipper under an agreement containing a grandfathered rollover right request a rollover for less than the minimum term stated in such agreement or at less than maximum rates, the contract would be subject to the ROFR process unless Northern and the party have otherwise agreed in writing.[38] The Settlement language provides that if the pipeline reaches an agreement with the shipper, the shipper may be permitted to extend its capacity without regard to whether it pays the maximum rate for the minimum period of time. In the instant case, although Distributors argue that it is unclear whether the capacity was extended pursuant to the rollover rights, it is clear that the shipper and the pipeline have reached a written agreement which would satisfy the terms of the settlement.

E. <u>Posting and Bidding of Capacity</u>

48. Distributors argue that Northern's filing is not consistent with the Commission's policy that capacity should go to the shipper that values it most because there has been no competitive bidding for the subject capacity. Distributors argue that beyond Commission policies and regulations, competitive bidding would show whether or not the discounts granted to Flint Hills are reasonable, whether or not there are other parties that are willing to pay more for some or all of the subject capacity, and whether the discounts and benefits granted to Flint Hills are, in fact, necessary to prevent cost shifting or harm to other shippers.

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[37] *MUD II*, 113 FERC ¶ 61,119 at P 48, *citing Northern Natural Gas Co.*, 64 FERC ¶ 61,073 (1993), *order on compliance and reh'g,* 65 FERC ¶ 61,011 (1993).

[38] Rollover of Less Than Entire Contract With Grandfathered Rollover Rights:

> The parties have agreed that should a shipper under an agreement containing a grandfathered rollover right request a rollover (i) for less than the minimum term stated in such agreement; (ii) at less than maximum rates, unless Northern and the party have otherwise agreed in writing, then the contract shall be subject to the ROFR process. However, if a shipper under an agreement containing a grandfathered rollover right requests a rollover of less than the maximum daily quantity (MDQ), then only that portion of the agreement for which a rollover was requested will remain subject to the grandfathered rollover right in the future. The remainder of the agreement shall be subject to the ROFR process. Settlement at Restructuring Proceeding, Article III F.4.a, pages 92-93.

49. Distributors assert that at the same time that Northern was negotiating the instant agreement, it was also soliciting interest in the construction of facilities to expand the capacity of its Market Area. Therefore, Distributors conclude that the capacity that would have been available had Flint Hills left the system could potentially have been sold at maximum rates or, at least, at rates higher than reflected in the discounted agreement and that this would have reduced or eliminated any need to build additional facilities. Distributors also argue that this calls into question the implicit assumption in Northern's filing that there is no market for the current Flint Hills capacity.

50. Distributors argue that the May 30 Order states that Northern is entitled to allocate its capacity in a manner consistent with its tariff. However, they argue that if this statement is taken at face value, any pipeline can completely undercut the fundamental principle that capacity should go to those that value it most. Further, Distributors argue that the May 30 Order states that 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. However, Distributors contend that there is no way to tell that the pipeline has sought the highest possible rate without placing the capacity up for auction. Additionally, Distributors contend that it is not always in the pipeline's own economic interest to seek the highest possible rate because the pipeline can be insulated from its failure to do so through a selective discounting adjustment in a future base rate case.

51. The Commission has responded to similar arguments in recent orders, and the findings of its May 30 Order is consistent with these prior orders.[39] First, as the Commission pointed out in these orders and in its 1989 Rate Design Policy Statement,[40] the Commission outlined its concerns with allocative and productive efficiency and stated that it is a necessary, but not the only, objective considered by the Commission. The Commission noted that although it had stated, on numerous occasions, that it favors placing capacity in the hands of those that value it most highly, it also 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 firm capacity (such as at issue here), 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. Consistent with this policy, Northern's tariff permits it to hold open

[39] *MUD II*, 113 FERC ¶ 61,119 at P 41-46; *Centerpoint I*, 110 FERC ¶ 61,321 at P 23-25; *Centerpoint II*, 111 FERC ¶ 61,379 at P 32-45; *Centerpoint III*, 113 FERC ¶ 61,188 at P 26-27, 29.

[40] 47 FERC ¶ 61,295, *order on reh'g*, 48 FERC ¶ 61,122 (1989).

seasons for capacity based upon the NPV allocation methodology but does not require the use of such a methodology.[41] 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. Therefore, the Commission has acted within its policies in permitting Northern to extend the use of the subject capacity to Flint Hills, without posting the capacity for bidding.[42]

52. Further, the Commission disagrees with Distributors' suggestion that pipelines are insulated from their failure to seek the highest possible rate because they may seek a discount adjustment in a future rate case. The Commission has previously stated:

> The Commission does not routinely grant pipelines a discount adjustment, but grants such an adjustment only to the extent that the discount was required to meet competition. The Commission has denied pipelines the adjustment where the pipeline has failed to meet its burden of showing that the discount was required to meet competition.[43] *A discount adjustment is not an entitlement and the pipelines would be ill-advised to consider it so.*[44]

53. Accordingly, the Commission denies rehearing on this issue.

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[41] *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").

[42] *TransColorado Gas Transmission Co.*, 109 FERC ¶ 61,117 (2004) (finding that pipelines are permitted to negotiate extensions to existing contracts at maximum or discounted rates without offering the subject capacity to other shippers).

[43] *See Panhandle Eastern Pipe Line Co*, 74 FERC ¶ 61,109, at 61,401-02 (1996); *Williams Natural Gas Co*, 77 FERC ¶ 61,277, at 62,206-07 (1996); *Trunkline Gas Co.*, 90 FERC ¶ 61,017, at 61,096 (2000); *Iroquois Gas Transmission System*, 84 FERC ¶ 61,086, at 61,476-78 (1998); *Trunkline Gas Co.*, 90 FERC ¶ 61,017, at 61,092-95 (2000).

[44] 113 FERC ¶ 61,173 at P 24 (emphasis added).

The Commission orders:

The request for rehearing of the Commission's May 30, 2006 Order is denied.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.