

126 FERC ¶ 61,120
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Acting Chairman;
Sudeen G. Kelly, Marc Spitzer,
and Philip D. Moeller.

Shell Energy North America (US), L.P.

Docket No. RP08-648-000

ORDER ON REQUEST FOR CLARIFICATION

(Issued February 13, 2009)

1. On July 21, 2008, Shell Energy North America (US), L.P. (Shell) filed a request for clarification of the Commission's right of first refusal policy as it applies to negotiated rate agreements. Shell asserts that, as a firm shipper currently paying the maximum tariff rate under a long term negotiated rate agreement with Tennessee Gas Pipeline Company (Tennessee), it should qualify for the regulatory right of first refusal established by Commission policy.

2. Under Shell's negotiated rate agreements with Tennessee, Shell pays the maximum Rate Schedule FT-A rates plus a surcharge for a portion of the term and, for the balance of the term, the maximum FT-A rates without the surcharge. Tennessee provides firm, Part 284 open access transportation service under Rate Schedule FT-A. Shell acquired the capacity through a permanent release from Pittsfield Generating Company, L.P. (Pittsfield), which held the capacity under almost identical negotiated rate agreements with Tennessee. In consideration of the negotiated rate arrangement, Pittsfield agreed to convert to Rate Schedule FT-A from Tennessee's Rate Schedule NET-284, a more limited open access service provided under an incremental rate, to Rate Schedule FT-A, a higher quality service.

3. Ocean State Power (OSP)¹ and the New England LDCs² support Shell's request for clarification and request similar relief for negotiated rate agreements with Tennessee that are similar in structure and origination (i.e., conversions from either NET or NET-284) (collectively, including Shell's, the Negotiated Contracts). Tennessee opposes the requests for clarification on the grounds that negotiated rate agreements, absent a contractual provision to the contrary, do not qualify for a regulatory right of first refusal.

4. On November 4, 2008, Tennessee issued a notice of the commencement of a non-binding open season for its proposed Northeast Supply Diversification Project (NSD Project). In the notice, Tennessee indicated that it intends to utilize capacity under contracts expiring November 2010 to November 2012, including the Negotiated Contracts, in the NSD Project. Shell, OSP, and the New England LDCs (collectively, the Conversion Shippers) claim that, without a right of first refusal, they will be forced to bid on and win capacity in the open season, including unneeded upstream capacity. In light of Tennessee's open season, Tennessee and the Conversion Shippers request expedited Commission action with respect to Shell's request for clarification.

5. For the reasons discussed below, the Commission denies the Conversion Shippers' request for clarification.

I. Background

A. Rate Schedules NET and NET-284

6. Between 1988 and 1992, the Commission certificated a number of expansion projects permitting Tennessee to provide non-open access, individually certificated Part 157 transportation service to various customers in the Northeast. The projects primarily involved additional mainline looping and compression in Tennessee's Rate Zones 5 and 6, comprising Tennessee's facilities in New York and New England.³ The Commission approved incremental initial rates for each of the projects. In 1992, the Commission

¹ OSP includes Ocean State Power (OSP I) and Ocean State Power II (OSP II).

² The New England LDCs include Bay State Gas Company (Bay State), the Berkshire Gas Company, Connecticut Natural Gas Corporation, Fitchburg Gas and Electric Light Company, City of Holyoke, Massachusetts Gas and Electric Department, Northern Utilities, Inc. (Northern), NSTAR Gas Company (NSTAR), the Southern Connecticut Gas Company, Westfield Gas & Electric Department, and Yankee Gas Services Company.

³ See *Opinion No. 406*, 76 FERC ¶ 61,022, at 61,108-9 (1996), for a description of the projects.

approved a settlement under which the separate rate schedules for each project were rolled into a single Rate Schedule NET. Service under that rate schedule continued to be a non-open access service provided at incremental rates, reflecting the costs of the various expansions.⁴

7. During Tennessee's Order No. 636 restructuring proceeding, Tennessee proposed to convert the Rate Schedule NET shippers' Part 157 service to Part 284 open access service by rolling in the costs to its Rate Schedule FT-A service.⁵ The Commission rejected Tennessee's proposal on the grounds that there was not a sufficient factual record to support the roll-in of the NET facilities.⁶ However, the Commission required Tennessee to permit the Rate Schedule NET shippers to convert to Part 284 service.⁷ In response to the Commission's order, Tennessee created a separate incremental Rate Schedule NET-284 service for those NET shippers and, in 1993, gave the NET shippers a one-time opportunity to convert to the NET-284 service.⁸

8. In 1999, Tennessee proposed to give its NET shippers another opportunity to convert to open access service under Rate Schedule NET-284. At the same time, it proposed to limit the NET-284 shippers' use of secondary receipt and delivery points to points within the NET-284 rate zone segment in which the shipper reserved capacity.⁹ This meant that the NET-284 shippers would be able to use secondary points in parts of the FT-A rate zones when they received service, rather than throughout those zones. After a technical conference, the Commission approved this proposal.¹⁰ In addition, in response to NET and NET-284 shippers who wanted flexible receipt and delivery points throughout the applicable FT-A rate zones, Tennessee clarified in its post-technical conference comments that it would allow NET and NET-284 shippers to convert to standard FT-A service under a negotiated rate agreement. Under such an agreement, the shipper would pay the FT-A usage rate plus the higher of the FT-A reservation rate or the shipper's existing reservation rate (in effect, the reservation rate for FT-A Part 284 open

⁴ *Tennessee Gas Pipeline Co.*, 63 FERC ¶ 61,095 (1993).

⁵ *Tennessee Gas Pipeline Co.*, 64 FERC ¶ 61,020, at 61,219 (1993).

⁶ *Id.* at 61,221.

⁷ *Id.*

⁸ *Tennessee Gas Pipeline Co.*, 65 FERC ¶ 61,224, at 62,055-56 (1993).

⁹ *Tennessee Gas Pipeline Co.*, 88 FERC ¶ 61,008 (1999).

¹⁰ *Tennessee Gas Pipeline Co.*, 89 FERC ¶ 61,051 (1999).

access service, plus a surcharge to reflect the incremental reservation charges). Tennessee stated that, when converting to a standard FT-A service in this manner, the NET or NET-284 shipper would receive the right to use flexible receipt and delivery points within the FT-A rate zones for which they pay, as opposed to rate segments applicable to NET-284 shippers. The Commission approved this proposal and stated that if NET or NET-284 shippers request to convert to FT-A service in this manner, Tennessee must file the appropriate application with the Commission.¹¹

B. Order No. 637

9. On February 2, 2000, the Commission issued Order No. 637¹² narrowing the right of first refusal.¹³ In the order, the Commission held that in the future the right of first refusal will apply only to maximum rate contracts for 12 or more consecutive months of service and, therefore, will not apply to discounted contracts or negotiated rate contracts. The Commission stated that limiting the right of first refusal to maximum rate contracts is consistent with its original purpose to protect long-term captive customers from the pipeline's monopoly power. The Commission stated that shippers that are not captive customers and have alternatives in the marketplace do not need the protection of the right of first refusal.¹⁴ The Commission found that this limitation on the right of first refusal strikes the appropriate balance between the need to protect captive customers and the need to better balance the risks between the shipper and the pipeline.¹⁵ On May 19, 2000, the Commission affirmed these holdings in Order No. 637-A and clarified that the right

¹¹ *Id.* at 61,156.

¹² *Regulation of Short-Term Natural Gas Transportation Services and Regulation of Interstate Natural Gas Transportation Services*, Order No. 637, FERC Stats. & Regs. ¶ 31,091, *clarified*, Order No. 637-A, FERC Stats. & Regs. ¶ 31,099, *reh'g denied*, Order No. 637-B, 92 FERC ¶ 61,062 (2000), *aff'd in part and remanded in part sub nom. Interstate Natural Gas Ass'n of America v. FERC*, 285 F.3d 18 (D.C. Cir. 2002)(*INGAA*), *order on remand*, 101 FERC ¶ 61,127 (2002), *order on reh'g*, 106 FERC ¶ 61,088 (2004), *aff'd sub nom. American Gas Ass'n v. FERC*, 428 F.3d 255 (D.C. Cir. 2005).

¹³ Order No. 637 became effective May 27, 2000.

¹⁴ Order No. 637, FERC Stats. & Regs. ¶ 31,091 at 31,337.

¹⁵ *Id.* at 31,355.

of first refusal does not apply to negotiated rate contracts regardless of whether the negotiated rate is lower or higher than the maximum tariff rate for the service.¹⁶

10. On July 26, 2000, in Order 637-B, the Commission responded to arguments that it had erred by depriving negotiated rate contracts that are at the maximum tariff rate right of first refusal protection and that a negotiated contract to pay the maximum rate should be treated as a contract at the maximum rate within the meaning of Order No. 637 and the Commission's regulations. In affirming its earlier decision, the Commission explained that, because a negotiated rate is not a tariff rate, it cannot be the maximum tariff rate within the meaning of the Commission's regulations, regardless of how the level of the negotiated rate compares to the level of the tariff rate. If a shipper wants to have the benefits of the right of first refusal so as to have a preference for continued service on the pipeline over other customers at the expiration of its contract, the Commission stated, it should take its service under the maximum just and reasonable tariff rate. If the shipper negotiates its rate, then it must compete equally with other shippers for the capacity at the end of its contract.

11. The Commission grandfathered existing discounted and negotiated rate contracts so that the right of first refusal would apply upon the expiration of those contracts, but explained that the right of first refusal would not apply to the re-executed contract unless it is at the maximum rate.

C. Conversion Agreements

12. In 2002, after the Order No. 637 rulemaking was completed, Tennessee filed negotiated rate contracts with Bay State, OSP, Northern, NSTAR, and Pittsfield, and in 2004, Tennessee filed negotiated rate contracts with Bay State, Northern and Shell.¹⁷ These negotiated rate contracts contain similarly structured negotiated rate arrangements, which, with the exception of Shell's negotiated contracts, which were acquired through a

¹⁶ Order No. 637-A, FERC Stats. & Regs. ¶ 31,099 at 31,634. The Commission defined "maximum rate" as the maximum tariff rate for a particular service and "negotiated rate" as a rate agreed to by the pipeline and the customer pursuant to the Commission's negotiated rate policy. *Id.* at 31,635.

¹⁷ Shell is the successor-in-interest to Coral Energy Resources, L.P. Shell states that Coral was merged into its parent, Shell, on June 1, 2008.

permanent release from Pittsfield, were in consideration of the NET or NET-284 shipper's conversion to Rate Schedule FT-A.¹⁸

13. Each negotiated rate contract consists of two documents: (a) a service agreement under Tennessee's Rate Schedule FT-A, which is based upon Tennessee's standard pro forma agreement and does not contain any material deviations, and (b) a letter agreement setting forth the terms of the negotiated rate arrangement. Under the negotiated rate arrangement, for a portion of the agreement term, the shipper pays the maximum FT-A reservation and commodity rates and applicable FT-A fuel and loss percentage, as each may change,¹⁹ plus a monthly per Dth surcharge.²⁰ During this same portion of the term, the shipper also had a throughput commitment and was obligated to refrain from filing or supporting any filing at the Commission that would decrease the rate under the agreements. For the balance of the term of the agreements, there is no surcharge and the shipper pays the effective maximum FT-A reservation and commodity rates and applicable FT-A surcharges and fuel and loss percentage.

D. Request for Clarification

14. On July 21, 2008, Shell filed a request for clarification of the Commission's right of first refusal policy regarding negotiated rate agreements.²¹ Shell requested that the Commission clarify that a firm shipper with a negotiated rate agreement requiring it to pay the pipeline's maximum recourse rate, as it may change from time to time, is eligible

¹⁸ See, e.g., *Tennessee Gas Pipeline Co.*, 100 FERC ¶ 61,151, at 61,558 (2002). NSTAR converted from NET service to FT-A service. The other converting shippers converted from NET-284 service.

¹⁹ Bay States' and Northern's negotiated contracts filed in Docket Nos. RP96-312-136 and -137 are unlike the other negotiated rate agreements in that the reservation and commodity rates for the surcharge portion of the agreements are fixed at Tennessee's effective FT-A reservation and commodity rates as of the commencement date of the respective agreements and, therefore, not subject to change.

²⁰ OSP, which are owner/operator of natural gas-fired electric generation facilities, and Tennessee both state that with respect to OSP's negotiated contracts, the additional surcharge imposed by the contracts represents the remaining costs of the incremental facilities used to serve OSP.

²¹ Shell's request was originally filed in Docket No. RP96-312-144 and RM98-10. On December 5, 2008, the Commission re-docketed Shell's request as Docket No. RP08-648-000, along with all subsequent pleadings relating to the matter in Docket No. RP08-648-000.

for the regulatory right of first refusal. OSP and the New England LDCs filed multiple comments in support of Shell's request and requested similar relief. Tennessee filed multiple answers in response to Shell, OSP and the New England LDCs, each time opposing their requests for clarification.

15. On November 17, 2008, OSP filed a letter informing the Commission that Tennessee was conducting an open season for an expansion project. According to Tennessee's November 4, 2008 notice, which OSP attached to its letter, Tennessee commenced a non-binding open season for its proposed NSD Project.²² The NSD Project involves two expansion project options, the Long-Haul and Tennessee-Iroquois Combination,²³ and both expansion projects will use "existing Tennessee Zone 5 to Zone 6 market area capacity that is held under expiring contracts until November 2010 to November 2012."²⁴ Tennessee states that though the open season is non-binding, only bids received during the open season period, which ended on December 4, 2008, will be considered for service for the NSD Project, unless otherwise agreed by Tennessee, in its sole discretion.²⁵

16. Shell and the New England LDCs filed separate letters requesting expedited Commission action in light of Tennessee's open season. On December 5, 2008, Tennessee filed a letter updating the Commission on the outcome of its open season and also requested expedited Commission action. In its letter, Tennessee confirmed that it intends to utilize the capacity underlying the Negotiated Contracts, which expire in 2010, 2011, and 2012, in the NSD Project. Tennessee also states that part of its intent behind the open season was to be in a position to report to the Commission the extent to which the market values the expiring capacity.²⁶ Tennessee also stated that neither Shell nor

²² According to Tennessee's notice, the NSD Project provides shippers with the opportunity to contract for firm transportation capacity from multiple existing and proposed new receipt points along Tennessee's system in the Gulf Coast, Rockies (via an interconnection with the REX pipeline system), and Appalachian, including Marcellus Shale, production regions to existing and proposed new delivery points across Tennessee's market area in upstate New York and New England, as well as Connecticut and New York City markets via the Iroquois Gas Transmission (Iroquois) system. OSP November 17, 2008 Letter Attachment A at 1.

²³ OSP November 17, 2008 Letter Attachment A at 1-2.

²⁴ OSP November 17, 2008 Letter Attachment A at 1.

²⁵ OSP November 17, 2008 Letter Attachment A at 3-4.

²⁶ Tennessee states that, in response to the 100,000 Dth/d of projected Long-Haul project capacity, Tennessee received 500,000 Dth/d of requests from open season

(continued...)

OSP submitted requests²⁷ and only one member of the New England LDCs submitted a request for a minor percentage of the total volume.

17. Without a right of first refusal, OSP and Shell claim that they could be forced to bid on and win additional upstream capacity as part of Tennessee's open season, including unneeded capacity. The New England LDCs claim that they may lose some or all of their capacity as part of the expansion and that the indicative rates in the open season notice (i.e., \$0.98/dth and \$1.06/dth) are three times higher than the rate shippers now pay for the same capacity rights (i.e., \$0.2403).²⁸

II. Discussion

18. For the reasons discussed below, the Commission denies the Conversion Shippers' request for clarification.

A. Right of First Refusal Policy

19. The Conversion Shippers all request that the Commission clarify that long term transportation service agreements, under which the shipper becomes obligated to pay the applicable maximum rate and is subject to the risk of Commission-approved changes in that rate, are eligible for a regulatory right of first refusal under section 284.221(d)(2)(ii) of the Commission's regulations, even if the agreement was filed and accepted by the Commission as a negotiated rate agreement. They contend that, contrary to the Commission's observation in Order No. 637-B that a negotiated rate shipper's rate "will be established by its contract regardless of the tariff or any changes to the tariff rate during the term of the negotiated rate contract," their Negotiated Contracts were

participants and, in response to the 500,000 Dth/d Tennessee-Iroquois Combination project, participants requested nearly 1.1 Bcf/d of capacity.

²⁷ OSP states that it did not participate in the open season because they did not wish to be seen as accepting that Tennessee has a right to force them to bid for unneeded capacity that is tied in the open season to their right to their existing capacity. OSP December 12, 2008 Comments at 3.

²⁸ New England LDCs November 25, 2008 Letter at 4.

“dependent upon” the maximum rates for FT-A service, as they may change,²⁹ and, after the surcharge portion of their agreements ended, their rates became fully subject to the tariff rate.³⁰ They maintain that the rate and at-risk status should govern, not the type of agreement or fact that they paid a rate other than the maximum applicable tariff rate for an earlier period of the agreement. The New England LDCs further argue that, as compared to a negotiated rate contract that may contain a discount or the possibility of a discount or is based upon market priced indices, under Shell’s and OSP’s contracts they cannot pay less than the maximum rate and should therefore qualify for a regulatory right of first refusal.

20. Shell maintains that in *East Tennessee*³¹ the Commission recognized that a shipper under a non-conforming firm transportation agreement that provided for the shipper to pay a discounted rate for the primary term and the applicable maximum rate during the secondary term qualifies for the regulatory right of first refusal at the end of the secondary term (but not at the end of the primary term). Shell claims that in light of *East Tennessee* it would qualify for a right of first refusal prior to the end of the contractual term in 2012 because it will be responsible for paying the applicable maximum FT-A tariff rate from August 1, 2007 through end of the contractual term.

21. Tennessee argues, that absent a contractual provision to the contrary, negotiated rate agreements are ineligible for a regulatory right of first refusal. If the Conversion Shippers believed negotiated rate treatment was inappropriate, Tennessee argues, they could have raised their objections in the Negotiated Contracts’ approval dockets. Tennessee also argues that granting the Conversion Shippers a regulatory right of first

²⁹ OSP August 5, 2008 Answer at 7 (emphasis added). However, this is not the case with Bay States’ and Northern’s negotiated rate agreements filed in Docket Nos. RP96-312-136 and RP96-312-137, wherein the reservation and commodity rates for a portion of the term of the agreements were fixed at Tennessee’s effective FT-A reservation and commodity rates as of the commencement date of the respective agreements.

³⁰ OSP adds that, during negotiation of its negotiated rate agreements, it did inquire concerning contract renewal rights. OSP states that Tennessee responded by explaining that they would be consistent with those available to FT-A shippers, which OSP contends means that, as an FT-A shipper, their contract renewal rights would include the regulatory right of first refusal whether or not renewal rights were included in the contract.

³¹ *East Tennessee Natural Gas, LLC*, 116 FERC ¶ 61,187, at P 8 (2006) (*East Tennessee*).

refusal would result in an unlawful retroactive change to a clearly stated Commission policy.

22. Tennessee argues that, unlike in *East Tennessee*, Shell's negotiated rate agreements involve only a single term during which Shell pays two rates and does not contain a contractual right of first refusal. Tennessee states that the parties in *East Tennessee* added the contractual right of first refusal because the discount rate rendered the agreement ineligible for a regulatory right of first refusal.³²

23. The Commission holds that the fact a negotiated rate contract requires the shipper to pay the pipeline's maximum FT-A rate, as it may change from time to time, does not entitle the shipper to a regulatory right of first refusal under the Commission's policy and regulations. The Commission's policy and regulations are clear. In Order No. 637, the Commission revised section 284.221(d)(2) of the Commission's regulations to limit the right of first refusal to shippers with firm contracts for service for twelve consecutive months or more at the applicable maximum rate for that service.³³ Order No. 637-A clarified that, because the right of first refusal will only apply to maximum rate contracts, there is no regulatory right of first refusal for contracts containing negotiated rates, regardless of whether the negotiated rate is lower or higher than the maximum tariff rate for the service.³⁴

24. On rehearing of Order No. 637-A, the New England LDCs sought the very same clarification which they, Shell, and OSP seek here – that a negotiated rate contract that requires the shipper to pay the pipeline's applicable maximum rate, as it may change from time to time, should be treated as a maximum rate contract eligible for the regulatory right of first refusal provided by section 284.221(d) of the Commission's regulations.³⁵ They contended that Order No. 637-A “erred in concluding that a shipper

³² The relevant provision reads as follows: “10.3 Notwithstanding any other provision of this Agreement or Transporter's General Term and Conditions, with respect to each Secondary Term under this Agreement, if (i) the MDTQ for the entire Secondary Term is 25,000 Dth, and (ii) the rate for service during the entire Secondary Term is the applicable maximum recourse rate on file with the Commission for service hereunder, then Shipper shall have the right of first refusal provided in Section 7.3(b) of the Transporter's General Terms and Conditions.”

³³ 18 C.F.R. § 284.221(d)(2) (2008).

³⁴ Order No. 637-A, FERC Stats. & Regs. ¶ 31,099 at 31,634.

³⁵ Request for Clarification and Rehearing of the New England Local Distribution Companies, filed in Docket Nos. RM98-10-000 and RM98-12-000 on June 16, 2000. The New England Local Distribution Companies submitting that request included all the
(continued...)

paying maximum rates pursuant to a negotiated rate contract is not entitled to a right of first refusal.”³⁶ As summarized by Order No. 637-B, the New England LDCs alleged that, “in negotiating the re-execution of existing contracts, certain pipelines insisted that captive shippers enter into negotiated rate contracts at the maximum tariff rate, and that these customers are subject to the pipeline’s monopoly power.”³⁷ Order No. 637-B also noted that another rehearing applicant asked that the Commission find that “a negotiated rate contract to pay the maximum rate is a contract at the maximum rate within the meaning of the discussion in Order No. 637 and revised section 284.221(d) of the Commission’s regulations.”³⁸ Thus, Order No. 637-B addressed the very same contentions the Conversion Shippers raise here, and Order No. 637-B clearly rejected those contentions. Order No. 637-B stated, “Because a negotiated rate is not a tariff rate, it cannot be the maximum tariff rate within the meaning of the Commission’s regulations regardless of how the level of the negotiated rate compares to the level of the tariff rate.”³⁹ The United States Court of Appeals for the District of Columbia Circuit affirmed this aspect of Order Nos. 637, 637-A, and 637-B in *INGAA*.⁴⁰

25. There is no dispute that the contracts at issue in this case are negotiated rate contracts. Pipelines may only enter into negotiated rate transactions if they have a tariff provision authorizing them to offer negotiated rates, and they must file each negotiated rate contract for Commission approval. Consistent with that policy, Tennessee’s Rate Schedule FT-A authorizes it to negotiate rates for that service, and Tennessee filed each of the negotiated contracts here at issue for Commission approval as negotiated rate transactions. Moreover, all of these negotiated rate contracts were executed in 2002 or 2004, two or four years after the Order No. 637 rulemaking proceeding was completed without objection from the Conversion Shippers. The Conversion Shippers, as knowledgeable participants in the natural gas industry, should reasonably have known that their negotiated contracts would not be eligible for a right of first refusal, particularly in light of the Commission’s express discussion of this issue in Order No. 637-B. It is immaterial that for a portion of the term of the negotiated rate agreement the Conversion

New England LDCs filing comments in this proceeding except Yankee Gas Services Company.

³⁶ *Id.* at 1.

³⁷ Order No. 637-B, 92 FERC at 61,173.

³⁸ *Id.*

³⁹ Order No. 637-B, 92 FERC at 61,173.

⁴⁰ *INGAA*, 285 F.3d at 54-56.

Shippers are paying the maximum tariff rates for FT-A service, as they may change.⁴¹ Contrary to the Conversion Shippers' assertion, their negotiated rate agreements did not stop being negotiated rate agreements, when they were only required to pay the maximum FT-A rates, as they may change. Because their agreements are negotiated rate agreements and because they do not contain a contractual right of first refusal, as was the case in *East Tennessee*, the Conversion Shippers are not entitled to right of first refusal under the Negotiated Contracts.

B. Exercise of Market Power

26. OSP argues that, even if the Commission's general policy is that shippers with negotiated rates at the maximum rate are not eligible for the regulatory right of first refusal, the Commission should find that the Conversion Shippers are entitled to a regulatory right of first refusal, given the Negotiated Contracts unique history and in order to mitigate Tennessee's exercise of market power. OSP states that the negotiated aspect of the agreements operated only as a vehicle to permit conversion to Part 284 service while enabling Tennessee to collect a surcharge for the difference between the higher NET-284 incremental rate and the lower FT-A rate. It did not, they claim, reflect the intent to deprive shippers of rights they would have had otherwise. OSP argues that theirs is a situation where despite entering into a negotiated rate agreement, and contrary to the Commission's supposition in Order No. 637, Tennessee still possessed market power. OSP claims that Tennessee's position is a naked attempt to seize control of their capacity in order to extort additional revenues it could not obtain if OSP was permitted to retain the capacity by matching the highest rate and term bid under the right of first refusal.

27. OSP also claims that their agreements were negotiated under conditions that were inconsistent with the Commission's negotiated rates policy, and therefore should be treated as agreements for service at the maximum rate for purposes of applying the regulatory right of first refusal. In the policy statement establishing the negotiated rate option,⁴² OSP states, the Commission emphasized the importance of recourse rates and

⁴¹ Regarding OSP's allegation that Tennessee told OSP that its contract renewal rights would be consistent with those available to FT-A shippers, Tennessee is correct; OSP has not offered any evidentiary support for its allegation. Further, even assuming Tennessee made such a statement, it does not follow that as an FT-A shipper OSP was automatically entitled to a regulatory right of first refusal. As stated previously, negotiated rate agreements, even for service under Rate Schedule FT-A, do not qualify for a regulatory right of first refusal.

⁴² OSP August 5, 2008 Answer at 10, citing *Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines*, 74 FERC ¶ 61,076 (1996) (Policy

services to the legitimacy of negotiated rates, stating that the availability of a recourse rate “mitigates market power.”⁴³ Accordingly, OSP argues, unless a shipper can opt for an available recourse rate and service, there is no basis for concluding that the rate was truly negotiated or not the product of pipeline market power.

28. OSP states that they did not have the option to take service at the recourse rate for Tennessee’s FT-A service. OSP states that Tennessee insisted that the maximum FT-A recourse rate would be inadequate to recover the remaining incremental cost of the facilities used to serve OSP and would not permit conversion from NET-284 service to FT-A service at the existing recourse rate, absent continued payments for such facilities. OSP also maintains that Tennessee’s tariff did not provide an incremental rate for this service under its Rate Schedule FT-A and the NET-284 service was not the same as FT-A

service as required by the Commission’s negotiated rates policy.⁴⁴ Therefore, without the prerequisite of a recourse rate and service against which it could compare the negotiated rate offered by Tennessee, OSP argues, their agreements should be treated as agreements at the maximum tariff for purposes of applying the regulatory right of first refusal.

29. Tennessee concedes that it would not agree to convert the Conversion Shippers service from NET-284 to FT-A at the maximum FT-A rate. Tennessee states that this request was unreasonable in light of the significant capital expenditure Tennessee made to be able to provide the NET-284 service. Tennessee states that ultimately it will receive less revenue via the FT-A service than it would have under the NET-284 contracts, even accounting for the surcharge component of the negotiated rate.⁴⁵ Further, contrary to OSP’s assertion, Tennessee states that its posting of the open season and the contemplation of using the Conversion Shippers’ expiring capacity in the NSD Project does not represent an illicit use of market power. Rather, Tennessee argues, it allows that marketplace to put the expiring capacity to its highest valued use. Tennessee contends

Statement), *order on clarification*, 74 FERC ¶61,194 (1996), *reh’g denied*, 75 FERC ¶ 61,024 (1996).

⁴³ OSP August 5, 2008 Answer at 10, citing Policy Statement, 74 FERC at 61,240.

⁴⁴ For example, OSP states, that NET-284 service did not include the same quality of flexible receipt and delivery points as provided by Rate Schedule FT-A. OSP August 5, 2008 Answer at 11, citing *Tennessee Gas Pipeline Co.*, 88 FERC ¶ 61,008 (1999); *Tennessee Gas Pipeline Co.*, 89 FERC ¶ 61,051 (1999).

⁴⁵ Tennessee August 13, 2008 Answer at 2.

that the open season to construct more capacity demonstrates that it is not exercising market power.⁴⁶

30. The Commission finds that these contentions by OSP do not justify a holding that the Conversion Shippers' contracts must include a regulatory right of first refusal. On appeal of Order No. 637, the court affirmed the Commission's exclusion of all discounted and negotiated rate contracts from the right of first refusal, despite the fact there may be some instances where, contrary to the Commission's general finding, pipelines do sometimes offer discounted or negotiated rates to captive customers even where they had market power.⁴⁷ The court stated that "generalizations are not automatically rendered invalid by examples to the contrary--the Commission is plainly entitled to respond with a general solution to general finding of a systematic condition or problem, rather than proceed with a case-by-case approach."⁴⁸ Further, the court added, there is nothing to suggest "that shippers on notice of the rule will be unable to avoid its consequences and enjoy the right of first refusal—so long as they are willing to pay the price."⁴⁹ Again, the Conversion Shippers, as knowledgeable participants in the natural gas industry, should reasonably have known that their negotiated contracts would not be eligible for a right of first refusal, even if they believe Tennessee was exercising market power. Moreover, if they believed that Tennessee was exercising market power, they could have raised the issue in the approval dockets. Instead, the Conversion Shippers voluntarily availed themselves of the opportunity to terminate their NET-284 contracts prematurely and convert to FT-A service under a negotiated contract. As a result, they lost their entitlement to a right of first refusal.

31. The fact that the Conversion Shippers did not have the option of taking Rate Schedule FT-A service pursuant to the FT-A recourse rate does not negate the fact that under the Commission's policy and regulations the regulatory right of first refusal does not apply to negotiated rate contracts. At the time the Conversion Shippers entered into these negotiated rate agreements, they were taking Rate Schedule NET or NET-284 service under contracts which had remaining terms continuing for six or more years. Thus, the Conversion Shippers had the option of continuing service under those Rate Schedules, which the Commission had approved as just and reasonable.

⁴⁶ Tennessee states that the Commission recently stated in Order No. 712-A that "basic economic theory holds that firms with market power, like pipelines, will construct less capacity than competitive firms." Tennessee December 5, 2008 Letter at 2.

⁴⁷ *INGAA*, 285 F.3d at 54.

⁴⁸ *Id.* at 55.

⁴⁹ *Id.*

32. In addition, these shippers' conversions to standard open access service entailed Tennessee agreeing to release them from their existing contractual obligations to take NET or NET-284 service so that they could take the higher quality FT-A open access service. The NET-284 shippers' conversions to FT-A service gave them flexible point rights over a greater part of the system than they had under Rate Schedule NET-284. Among other things, this gave them a greater ability to release their capacity in competition with Tennessee's interruptible and short-term firm services. NSTAR's conversion from Rate Schedule NET service to FT-A service gave it flexible point and capacity release rights for the first time. Tennessee nevertheless agreed to allow the conversions at a negotiated rate equal to the FT-A maximum rate, plus a temporary surcharge that essentially replicated the same incremental rate the shippers were previously paying Tennessee under Rate Schedules NET or NET-284.

33. The Conversion Shippers' agreement to pay negotiated rates equal to the FT-A maximum rate plus a surcharge in order to receive additional FT-A flexible points rights is comparable to an example the New England LDCs provided in their request for rehearing of Order No. 637-A of a shipper paying a negotiated rate equal to the pipeline's maximum rate but receiving a special right to reduce its contract demand before the expiration of the contract.⁵⁰ The New England LDCs argued that in such a situation the shipper should be treated as a captive shipper eligible for the regulatory right of first refusal, despite the fact its contract was filed as a negotiated rate. However, as discussed above, Order No. 637-B denied the New England LDCs' rehearing request, and reaffirmed the blanket rule that no negotiated rate contract would be eligible for the regulatory right of first refusal, regardless of the nature of the negotiated rate.

34. As stated above, the Negotiated Contracts were filed with and accepted by the Commission as negotiated rate agreements after Order No. 637 and without objection from the Conversion Shippers. If the Conversion Shippers believed that their agreements should include a right of first refusal despite the Commission's rule that negotiated rate agreements are not eligible for such a right, they could have raised the issue in the approval proceedings, but they did not. It is too late, four or more years after the negotiated rate contracts were executed, filed, and approved by the Commission, for the Conversion Shippers now to be seeking a right of first refusal which the contracts they entered into did not give them.

C. Right of First Refusal Under Tennessee's Tariff

35. Even if the Commission concludes that the Negotiated Contracts are truly negotiated rate agreements and therefore, not entitled to regulatory right of first refusal,

⁵⁰ See Order No. 637-B, 92 FERC at 61,173 n.42.

several of the Conversion Shippers maintain that they are entitled to a right of first refusal pursuant to section 10.4.1 of the General Terms and Conditions (GT&C) of Tennessee's FERC Gas Tariff. Section 10.4.1 of the GT&C states:

Unless Transporter and Shipper expressly agree otherwise in Shipper's service agreement, this Article III, Section 10.4 shall apply only to long term firm service agreements at the applicable maximum rate or to long term firm service agreements entered into prior to March 27, 2000 (qualifying agreement(s)). A Shipper holding a qualifying agreement may exercise a right-of-first refusal in accordance with, and subject to, the procedures and limitations set forth below; provided, however, that if the qualifying agreement is at a negotiated or less than maximum rate, such agreement must be extended at the applicable maximum rate for a term of one year or more in order to retain a right-of-first refusal beyond the extended term. Unless Transporter and Shipper expressly agree otherwise in Shipper's service agreement, a right-of-first refusal does not apply to negotiated rate arrangements, to firm service agreements at less than the applicable maximum rate, to firm service agreements with a term of less than one year or to a geographic portion of the transportation service.

36. The Conversion Shippers contend that their negotiated rate agreements are "qualifying agreements" as defined in the first sentence of section 10.4.1 because they are long term firm service agreements at the applicable maximum rate. Accordingly, under the second sentence of section 10.4.1, they contend that they should be eligible for a right of first refusal if they agree to extend the agreement for at least another year at the applicable maximum rate.⁵¹

⁵¹ Shell also argues that Tennessee's form of service agreement for firm transportation service under Rate Schedule FT-A, in conjunction with section 10.4 of the GT&C, creates an ambiguity with respect to a shipper's eligibility for a right of first refusal. Specifically, Shell states that the use of the phrase "any rights" in section 12.1 of the service agreement implies that the shipper has a right of first refusal under the tariff and the tariff points back to the service agreement for evidence of express agreement. Shell states that the Commission may wish to direct Tennessee to modify its tariff and form of service agreement to make it more clear what constitutes an express agreement in the form of service agreement.

37. In its answer, Tennessee argues that the Commission should reject the Conversion Shippers' interpretation of section 10.4.1 of the GT&C on the grounds that it is contrary to Commission policy as well as the evidentiary record in the proceeding approving the language. Tennessee states that in its October 2, 2000 transmittal letter accompanying the proposed tariff sheets containing GT&C section 10.4.1, in Docket No. RP01-20, it stated:

Unless mutually agreed otherwise, negotiated rate arrangements and discount agreements executed after March 27, 2000, the effective date of Order No. 637, will have no ROFR rights. In accordance with Order No. 637, the proposed tariff provision grandfathers ROFR rights of existing shippers that entered into negotiated rate arrangements or long term agreements at less than maximum rate prior to March 27, 2000.

38. Tennessee maintains that the reference to negotiated or less than maximum rate agreements is clearly inapplicable to the Negotiated Contracts because they were entered into after March 27, 2000. In addition, Tennessee argues, GT&C section 10.4.1 precludes the agreements from qualifying for a regulatory right of first refusal because the agreements are negotiated rate packages. Tennessee states that no other party filed comments regarding the language and the Commission approved the language as filed.

39. After reviewing Tennessee's tariff, we find that Tennessee's interpretation is reasonable.⁵² In section 10.4.1 of the GT&C, it states that, unless transporter and shipper expressly agree otherwise in shipper's service agreement, a right of first refusal does not apply to negotiated rate arrangements. Further, under section 10.4.1, unless transporter and shipper expressly agree otherwise in shipper's service agreement, only long term firm service agreements at the applicable maximum rate or long term firm service agreements entered into prior to March 27, 2000 are eligible for right of first refusal. The Negotiated Contracts satisfy neither category. The Negotiated Contracts were not entered into prior to March 27, 2000, the effective date of Order No. 637, nor are they agreements at the maximum rate and therefore, they do not qualify for a right of first refusal under Tennessee's tariff.

⁵² See *Tennessee Gas Pipeline Company*, 104 FERC ¶ 61,010 (2003) (finding that a long term negotiated rate agreement for firm service entered into after March 27, 2000 did not qualify for a right of first refusal under Article III, section 10.4 of Tennessee's tariff).

D. Undue Discrimination

40. Several of the Conversion Shippers also claim that Tennessee's refusal to grant a right of first refusal to the Conversion Shippers when it granted such rights to other conversion customers is unduly discriminatory. They point to two negotiated rate agreements Tennessee entered into with Consolidation Edison Company of New York, Inc. (ConEd). Those agreements were the result of ConEd's conversion from incremental Part 157 services to service under Tennessee's Rate Schedule FT-A and in the agreement, Tennessee granted ConEd a one-time exercise of a rollover or right of first refusal upon the expiration of the contract term. In the April 21, 2000 order accepting Tennessee's filing,⁵³ the Commission required Tennessee to make the right of first refusal available to similarly-situated shippers on a non-discriminatory, non-preferential basis.⁵⁴ Several of the Conversion Shippers argue that they, as well as other former NET-284 shippers, are similarly situated to ConEd because they too entered into their negotiated rate agreements with Tennessee as part of the process of converting from Part 157 services to Rate Schedule FT-A service, and Tennessee's failure to offer them a right of first refusal was unduly discriminatory and in violation of the Commission's order.

41. Tennessee argues that the Conversion Shippers are not similarly situated to ConEd. Tennessee states that, unlike the Negotiated Contracts, the ConEd negotiated rate arrangement involved the comprehensive restructuring of multiple agreements, which included the conversion of certain Part 157 agreements to Part 284 service under Rate Schedule FT-A. Tennessee states that it was in consideration of ConEd extending its contracts and keeping Tennessee whole on the converted agreements' rates that Tennessee granted ConEd a contractual right of first refusal.⁵⁵ By contrast, Tennessee argues, the Negotiated Contracts were not extended and involved only the conversion of one agreement (or in some circumstances multiple related agreements). Further,

⁵³ *Tennessee Gas Pipeline Co.*, 91 FERC ¶ 61,070 (2000).

⁵⁴ OSP December 12, 2008 Comments at 3; New England LDCs December 12, 2008 Comments at 3-4.

⁵⁵ Tennessee states that the Rate Schedule FT-A agreements that resulted from the conversion of the Rate Schedule CGT-NY agreements called for a demand charge equal to the amount previously paid under Rate Schedule CGT-NY, plus a commodity charge equal to the then-effective Rate Schedule FT-A rate. Thus, if no gas flowed, Tennessee states, it would have received the same revenue as it would have without the conversion. Every dekatherm of gas that flowed would provide incremental revenue in the form of commodity charges that were higher than the rates under the pre-conversion agreements. Tennessee December 16, 2008 Comments at 3 n.3.

Tennessee contends that ConEd's package provided Tennessee with a net present value benefit, which helped to support the provision of a contractual right of first refusal. Tennessee states that the Negotiated Contracts resulted in Tennessee receiving less revenue in total than had it continued to provide service under the pre-conversion contracts and adding a contractual right of first refusal to the equation would only serve to further lower the value Tennessee received from agreeing to the Negotiated Contracts.

42. When implementing a negotiated rate contract, Commission regulations require that a pipeline file either the negotiated contract itself or a tariff sheet reflecting the essential elements of the negotiated rate agreement and make certain disclosures related to the negotiated contract. These filing requirements are designed to permit the Commission and shippers to efficiently ascertain whether the proposed negotiated transaction entails such a risk of undue discrimination that it cannot be permitted or whether other similarly situated shippers may be able to obtain such service. The Negotiated Contracts were entered into after Tennessee filed the ConEd agreements. As intended by the Commission's regulations, the terms of ConEd's negotiated contract were made public to Conversion Shippers to enable them to evaluate whether they could obtain such a right. If the Conversion Shippers concluded that they were similarly situated to ConEd and therefore, deserving of a similar contractual right of first refusal, they could have requested the same from Tennessee and, if Tennessee denied their request, they could have filed a complaint with the Commission.⁵⁶ OSP and the New England LDCs have not provided any legitimate reasons as to why they have waited these many years to raise this issue.

43. In any event, OSP's and the New England LDCs' claims of undue discrimination are unpersuasive. Tennessee states that it offered ConEd the contractual right of first refusal because, unlike the Conversion Shippers, ConEd extended the term of their agreements, kept Tennessee whole on the converted agreements rate and represented a higher net present value. Based upon these distinctions, it is readily apparent that the Conversion Shippers were not similarly situated to ConEd and therefore, not entitled to a contractual right of first refusal.

44. Finally, with regard to the Conversion Shippers' concerns about Tennessee's open season for the NSD Project, section 5.8 of Tennessee's GT&C requires that "prior to reserving Expired Contract Capacity, Transporter must make Expired Contract Capacity generally available for bidding through an open season." This gives shippers that do not wish to participate in the expansion an opportunity to obtain the capacity before it is

⁵⁶ Policy Statement, 74 FERC at 61,242.

reserved for the expansion.⁵⁷ Thus, the Conversion Shippers will have an opportunity to participate in that pre-reservation open season in order to retain their capacity without participating in the expansion.

45. For the foregoing reasons, the Conversion Shippers' request for clarification is denied.

By the Commission. Commissioner Kelliher is not participating.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

⁵⁷ Tennessee may impose the same minimum terms and conditions in the pre-reservation open season for expired capacity as in the expansion open season. *Tennessee Gas Pipeline Co.*, 86 FERC ¶ 61,066, at 61,261 (1999).