

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
William L. Massey, and Nora Mead Brownell.

Burlington Resources Oil & Gas Company
Northern Natural Gas Company
Continental Energy

Docket Nos. GP99-15-002,
RP98-39-002
SA98-101-002

ORDER DENYING REHEARING

(Issued September 23, 2003)

1. Burlington Resources Oil & Gas Company (Burlington) requests rehearing of the Commission's April 1, 2003 Order (the April 1 Order)¹ that denied Burlington's request for rehearing of the Commission's January 2, 2003 Order² (the January 2 Order). The January 2 Order established a hearing to resolve disputes regarding the proper ad valorem tax refund amounts that were due and payable by Burlington to Northern Natural Gas Co. (Northern). The April 1 Order found that Burlington was obligated to make the refund, and directed it to make the payment. For the reasons set forth, the Commission denies rehearing.

Background

2. Burlington is the successor to Southland Royalty Company (Southland). Southland was a producer of natural gas, and sold natural gas to Northern. The price included, as an add-on, the Kansas ad valorem taxes that resulted in Southland collecting amounts in excess of the Maximum Lawful Price (MLP) established pursuant to the Natural Gas Policy Act (NGPA) of 1978. After the Commission held that under the

¹103 FERC ¶ 61,005 (2003).

²102 FERC ¶ 61,003 (2003).

NGPA the ad valorem tax was not a permissible add-on to the MLP and the Commission ordered producers to refund the excess amount over the MLP that they had collected, Northern sent a statement to Southland indicating that Southland owed ad valorem tax refunds to Northern. Burlington, in its responses to Northern, and in a Petition for Resolution in Docket No. GP99-15-001, asserted that it was not responsible for the refunds because of a February 28, 1989 Settlement between Southland and Northern (the 1989 Settlement).

3. A number of other producers also filed various pleadings with the Commission, asserting that the refund amounts claimed by Northern were incorrect, or seeking relief from the refunds for various other reasons. To resolve these disputes the parties participated in extensive settlement discussions which led to the Commission's approval of a settlement on December 27, 2000 (the 2000 Settlement).³ However, because persons could elect not to be bound by that settlement, and Burlington so elected, Northern's refund report of May 20, 2002, showed Burlington as owing \$914,751.42 in ad valorem tax refunds.

4. Burlington's position in requesting that the Commission find that it did not owe any refund was that a 1989 Settlement between Northern and Burlington's predecessor, Southland, released and indemnified Burlington for any claims for refund of Kansas ad valorem taxes. Burlington stated that under that settlement, which covered 30 gas contracts in three states, including some in Kansas, Southland gave up substantial take-or-pay claims, and agreed to reform the terms of the gas contracts, and the settlement included a mutual agreement to release and indemnify the other party for all claims arising from or relating to the gas contracts under which the ad valorem tax reimbursements were paid.

5. Burlington relied upon paragraph 5 of the Settlement which provided as follows:

Execution of this Settlement Agreement resolves all disputes between the parties under any and all of said Contracts, and Northern and Seller each hereby fully, completely, and finally releases and discharges the other . . . affiliates, parents or subsidiary corporations, and their respective successors and assigns from any and all liabilities, claims, and causes of

³Northern Natural Gas Company, 93 FERC ¶ 61,311 (2000).

action, whether at law or in equity, and whether now known and asserted or hereafter discovered, arising out of, or in conjunction with, or relating to said Contracts for all periods through January 31, 1989

6. Burlington stated that it did not claim that it had received less than the MLP for the gas so that it was entitled to collect the ad valorem taxes without violating the MLP. Rather, Burlington argued that Northern in the 1989 Settlement agreed to indemnify and release Burlington for all claims arising from or relating to Burlington's sale of gas to Northern, and, therefore, Northern is the party responsible for making any ad valorem tax refunds, not Burlington.

7. Burlington argued that giving effect to settlement, and requiring Northern to pay the ad valorem refund amount to its customers, will not cause Southland to have violated the NGPA because to the extent Southland might have received in excess of the MLP for gas sold to Northern, Southland had reimbursed Northern well in excess of that amount through the consideration provided to Northern in the form of take-or-pay relief under the 1989 Settlement. In addition, Southland agreed to reform the gas contracts to reduce both the contract price and Northern's take obligations in the future. Thus, Northern's customers, who would receive the ad valorem tax refund, have benefitted from Northern's lower gas costs that resulted from the Settlement. Burlington contended that under the 1989 Settlement Southland received only about 10 cents on the dollar that it was entitled to under the gas contracts.

8. Finally, Burlington asserted that if the Commission would find that enforcing the indemnification provision in the Settlement would result in a technical violation of NGPA ceiling prices, the Commission has the authority to grant Burlington an exemption under NGPA Section 502(c), 15 U.S.C. § 3412(c), in order to avoid inequity. Burlington contended that such relief would be justified because Northern (and indirectly its sales customers) have already received and enjoyed the benefits of the 1989 Settlement in the form of take-or-pay relief and contract reformation, and should not be able to ignore the other provisions of that settlement.

9. The April 1 Order first questioned whether the clause Burlington was relying upon had the meaning Burlington attributed to it, namely that it indemnifies Burlington for any

ad valorem tax refund liability and imposes that liability upon Northern.⁴ However, the order did not address that question stating that even if the clause could be read as having that meaning, Burlington could not prevail on its request to be relieved of the ad valorem refund liability.

10. The April 1 Order held that the purported "indemnity" clause in the 1989 settlement could not relieve Burlington of the ad valorem refund liability, which it admits is owing. It found no merit in Burlington's contention that under the settlement, the pipeline purchaser, not Burlington, must pay the refund because Commission precedent is clearly contrary to Burlington's position, citing Williams Natural Gas Co., 67 FERC ¶ 61,153 (1994) (Williams) and Anadarko Petroleum Corp. v. Pan Energy Pipe Line Co., et al., 85 FERC ¶ 61,090 (Anadarko).

11. The April 1 Order also found no merit in Burlington's argument that giving effect to the indemnity clause here would not result in Northern paying more than the MLP for the gas it purchased from Southland before January 31, 1989. The order stated that giving the clause the effect that Burlington seeks, namely that Burlington did not have to pay the refund, results in that very outcome because the producer will be permitted to retain the excess over the MLP.

12. The Order also addressed and found no merit in Burlington's other contentions that there is no statutory prohibition against a pipeline contractually assuming a liability of a producer, and that the Commission had approved settlements wherein the pipelines were able to retain the ad valorem tax refund rather than flowing them through to the customers who had overpaid.⁵ Burlington had argued that since the Commission has found that consumers, i.e., the intended NGPA statutory beneficiary, are bound by their contractual settlement agreements with pipelines giving up the right to any refund the

⁴Northern had asserted that Burlington mischaracterized the 1989 settlement in asserting that the settlement released Southland from any refund obligation. Northern stated that it did not agree in that settlement to allow Southland to keep amounts in excess of the MLP, or to release or indemnify Southland from its Kansas ad valorem tax refund liability for amounts received in excess of the MLP.

⁵Burlington cited El Paso Natural Gas Co., 85 FERC ¶ 61,003 (1998); Natural Gas Pipeline Co. of America, 85 FERC ¶ 61,004 (1998); and ANR Pipeline Co., 85 FERC ¶ 61,005 (1998).

pipeline recovered, so too the pipeline should similarly be bound by its contractual agreement with the producer regarding that refund. The April 1 Order held that while there is a bar to the first sale buyer agreeing to pay more than the MLP, since Section 504(a) of the NGPA makes it "unlawful for any person (1) to sell natural gas at a first sale price in excess of any applicable maximum lawful price under this Act..."⁶, the cases cited by Burlington only involved the pipeline's flow through of the refund, which is governed by the NGA, which does not provide any Congressionally-mandated MLPs.

13. Finally, the April 1 Order denied the request for exception relief under Section 502(c) since Burlington had not shown that its payment of the refund would cause it to suffer a hardship or inequity, but that Southern had merely had urged the same arguments it had presented why it should not be liable for the refund, which the order had rejected.

Burlington's Request for Rehearing of the April 1 Order

14. Burlington basically reiterates the argument that the April 1 Order addressed and rejected. Burlington contends that the April 1 Order failed to recognize and totally disregarded the mutual exchange of valuable consideration under the arm's-length 1989 Settlement, and thereby erroneously treated the operation of Northern's release and indemnification in isolation. Burlington argues that the Commission's conclusion that giving the indemnification clause its clear meaning would result in Burlington's receipt of more than MLP is flawed because it does not take into account the valuable consideration given to Northern under the 1989 Settlement, including the reduction in Northern's take-or-pay liability, which reduction alone exceeded the amount of Burlington's recovery of the ad valorem tax reimbursements here at issue.

15. Burlington also argues that there is no Commission precedent that is controlling, and that the cases cited in the April 1 Order, Williams and Anadarko are distinguishable. It asserts that the Commission has never directly addressed the question whether a release and indemnification provision in an agreement between a producer and a pipeline, which operates to allow the producer to retain amounts received in excess of the MLP, is enforceable in the context of an arm's-length, omnibus contract settlement providing for a substantial reduction in a pipeline's take-or-pay liability, contract reformation including reductions in future prices and pipeline take obligations.

⁶15 U.S.C. § 3414(a).

16. Burlington contends that in Williams the issue presented was the prudence of the pipeline's take-or-pay settlements and their recoverability from the pipeline's customers under a subsequent settlement providing for the pass through to the pipeline's customers of the take-or-pay settlement amounts. The issue presented to the Commission was the pipeline's prudence in entering into the take-or-pay settlements. The Commission's statement in Williams cited by the April 1 Order that producers must refund amounts in excess of the MLP regardless of release and indemnification provisions contained in take-or-pay settlements was merely dicta because the lawfulness of pipelines' agreements to indemnify and release producers in such settlements was not before the Commission.

17. Similarly, it contends that Anadarko is also inapposite. There, the Commission was presented with the question of whether a producer could shift liability for ad valorem tax refunds under a non-arm's length, spin-off agreement (and related subsequent agreements) under which Anadarko and its former parent purported to assign responsibility for liabilities under a contractual release. Burlington contends that unlike the 1989 Settlement here at issue, the spin-off agreement was not arm's-length, and there was no indication that the producer had given its pipeline parent any valuable consideration in return for the release.

18. Burlington also argues that the April 1 Order erroneously disregarded the relevance of settlements between pipelines and their customers which allowed the pipelines to retain ad valorem tax refunds received from producers on the grounds that those settlements were approved under the NGA, which does not provide for "Congressionally-mandated MLPs" and, therefore, "raises other considerations than those present here." Burlington contends that the Commission ignored the fact that Section 601 of the NGPA specifically deems the NGPA MLPs to be just and reasonable, and does not authorize pipelines to passthrough to their customers more than the NGPA MLPs. Therefore, it asserts, the settlements between pipelines and their customers are relevant here, and the Commission's approval of those settlements demonstrates that the arm's-length agreement between Northern and Southland is fully enforceable and consistent with the NGPA.

19. Similarly, it contends that the April 1 Order's explanation of why Northern's 2000 settlement of the ad valorem tax refund claims was not similar to the 1989 Settlement's indemnification clause is wanting. First, the April 1 Order stated that in that settlement "producers agreed to immediate payment of a substantial part of the refund in dispute" and here, "Burlington seeks to be relieved of the entire amount of the refund...." Burlington argues the 2000 Settlement in fact eliminated in full the refund obligations of some producers, just as the 1989 Settlement would eliminate the entirety of Burlington's

obligation. In fact, Burlington argues, while the 2000 Settlement reduced the amount of refunds, the 1989 Settlement merely shifts the refund obligation to Northern. Second, the April 1 order stated that Northern agreed to the 2000 Settlement while it "objects to Burlington's request." Burlington contends that the April 1 Order failed to recognize that Northern agreed to the 1989 Settlement just as it agreed to the 2000 Settlement. Burlington asserts that Northern here is seeking to avoid the obligations it agreed to undertake under the 1989 Settlement, while retaining all of the valuable consideration it received under that Settlement.

20. Finally Burlington argues that the rejection of its request for adjustment relief under NGPA, Section 502 is arbitrary and capricious because the April 1 Order rejected the request but provided no explanation for its decision.

Discussion

21. The Commission denies Burlington's request for rehearing. The request basically repeats all the arguments that the Commission considered and rejected in the April 1 Order. The thrust of its request here is that the April 1 Order, while noting that Southland gave valuable consideration in exchange for the indemnification clause in the Settlement, gives that fact no weight. Burlington argues that the presence of valuable consideration distinguishes this case from the Commission cases cited in the April 1 Order, so that they are not controlling.

22. Burlington's argument is not persuasive. In the April 1 Order, the Commission explained why Williams was on point and controlling. The Order stated that in Williams, the Commission expressly addressed the issue of whether a pipeline's settlement with producers resolving take-or-pay liabilities and reforming gas sales contracts, could relieve those producers of the liability for ad valorem tax refunds relating to those contracts. In Williams the pipeline had entered into that type of settlement with producers and sought to recover the costs pursuant to the mechanism in its tariff governing its recovery of Order Nos. 500/528 take-or-pay settlement costs and Order No. 636 gas supply realignment (GSR) costs. A state commission argued that it could not evaluate the prudence of the settlements because the settlements might have relieved producers of their ad valorem tax refund liability to the detriment of the pipeline's customers who would have received those refunds. The Commission rejected that argument stating:

To the extent producers are required to make refunds in [the ad valorem tax refund] ... case of amounts charged in excess of ceiling prices, they must make such refunds regardless of any agreement by their customers to pay amounts in excess of the ceiling price. Thus, take-or-pay or GSR settlements between pipelines and their producer/suppliers cannot interfere with refunds required by the Commission to remedy violations of NGPA ceiling prices, or with the flowthrough of such refunds by the pipelines to their customers.⁷

Consistent with Williams, the 1989 settlement at issue here could not relieve Burlington of its obligation to make ad valorem tax refunds to the pipeline.

23. Similarly, in Anadarko the Commission reiterated that a release provision between a producer and a pipeline could not relieve the first seller of its liability to refund any NGPA overcharge. The Commission explained:

Anadarko, as the first seller, is responsible for paying the refund. Anadarko's reliance on the release in the 1986 Spin-Off Agreement to refund the overcharge is misplaced. Whatever the parties intended by that release, it cannot relieve the first seller of the obligation to refund an NGPA overcharge, because the buyer and a first seller cannot agree to pay more than the MLP, which would be the effect that Anadarko seeks.⁸ (emphasis added)

24. On rehearing the Commission reaffirmed that ruling because such an agreement by a pipeline to be responsible for a producer's Kansas ad valorem tax refund liability would be illegal and unenforceable. The Commission stated:

[A]n agreement by the buyer, here Panhandle, to be responsible for any refund would be in effect an illegal

⁷67 FERC at 61,450.

⁸85 FERC at 61,331.

agreement to pay more than the MLP, and thus unenforceable.⁹

25. In short, these cases make clear that the producer and its pipeline-buyer, by themselves alone, could not enter into an agreement to make the pipeline responsible for any ad valorem tax refund. As discussed further below, that situation differs from the ad valorem tax refund settlements which included the pipeline's customers as parties to the agreement, which the Commission has approved.

26. Burlington's argument that not giving effect to the indemnification clause is inconsistent with Commission's approval of Northern's 2000 Settlement, under which the refunds claimed from settling producers were either eliminated or reduced, is similarly unavailing. While the NGPA ceiling prices were Congressionally mandated, the Commission does have a degree of prosecutorial discretion in determining how to expend its resources in the enforcement of those ceiling prices.¹⁰ Northern's 2000 Settlement, unlike Northern's settlement with Southland, was not simply a settlement between it and producers owing refunds. Rather, Northern's customers and affected state commissions were also parties to the 2000 Settlement, and all of them either supported or did not oppose the settlement. In light of that fact, the Commission approved the settlement as a means of obtaining for those customers the maximum amount of refunds practical. As a result some producers were entirely relieved of their ad valorem tax obligation, but this only was true as to the smaller claims. Customers only agreed to waive part of the refunds. Thus, considering the total refund amount, only a portion of it was waived, in order to collect the larger amount without further delay, and the expenditure of resources. Where the customers agree to the waiver of part of the claimed refund amount, which amount producers were contesting, the Commission may accept the settlement in the

⁹86 FERC at 61,158.

¹⁰The Commission has ceased efforts to recover refunds when it has concluded that the expenditure of further Commission resources was unwarranted. The Commission has taken such action as to ad valorem tax refunds, Northern Natural Gas Company, 102 FERC ¶ 61,015 (2003); NGA/NGPA ceiling prices, Stowers Oil & Gas Company, 71 FERC ¶ 61,383 (1995); and NGPA Btu refunds, Refunds Resulting from Btu Measurement Adjustments; Proposed Commission Action, FERC Statutes & Regulations ¶ 35,020 (February 14, 1991).

exercise of its prosecutorial discretion to resolve a controversy without the undue expenditure of resources.

27. This is markedly different than the 1989 Northern-Southland settlement of take-or-pay claims which did not involve the pipeline's customers, and was not filed with the Commission for its approval. At most, Northern would have filed with the Commission to flow through the costs of the settlement pursuant to Order Nos. 500/528 or as Order No. 636 GSR costs and the only issue before the Commission would be the prudence of the settlement. In that situation the matter would be similar to Williams, where the Commission stated that the take-or-pay settlement would not relieve the producer of the liability of any possible ad valorem tax refunds.

28. The purpose of Northern's 2000 settlement was to obtain refunds without the necessity of prolonged litigation, and the terms of the settlement were crafted accordingly. Burlington could have joined the settlement and paid less than the full amount Northern had claimed it owed, as other producers had done in joining the settlement. Instead it chose to seek complete elimination of the obligation. Thus, Burlington cannot claim that it is similar to the producers whose refunds amounts were small, and under the 2000 settlement, were relieved of that liability.

29. Similarly, Burlington's reliance on the Commission's orders in El Paso Natural Gas Co., 85 FERC ¶ 61,003 (1998); Natural Gas Pipeline Co. of America, 85 FERC ¶ 61,004 (1998); and ANR Pipeline Co., 85 FERC ¶ 61,005 (1998) is unavailing. In those orders, the Commission held that prior settlements between the pipelines and their customers permitted those pipelines to retain the ad valorem tax refunds they received from producers and not flow them through to their customers. Burlington contests the Commission's distinction that approval of the customers' agreement to waive the pipelines' flow through of the ad valorem refunds comes under the NGA, so the NGPA congressionally mandated MLPs are not involved. It argues that NGPA Section 601, deeming the amounts paid to producers up to the ceiling price to be just and reasonable, makes the NGA relevant also to any agreement between the producer and the pipeline to waive the producer's payment of refunds to the pipeline.

30. However, NGPA Section 601 does not change the fact that the NGPA ceiling prices are Congressionally mandated and may not be altered by the Commission pursuant to its NGA jurisdiction. In fact, the primary purpose of NGPA Section 601 was to carry out Congress's intent to remove the prices charged in first sales from the Commission's NGA jurisdiction. Moreover, NGA Section 601(c) only prevents the Commission from denying the pipeline's right to pass through the cost of any MLP gas to their customers; it

does not affect the Commission's discretion under the NGA to permit customers to waive receipt of NGPA refunds as part of an overall settlement with the pipeline concerning its NGA jurisdictional rates. Whether or not the pipeline can keep the ad valorem refund under its agreement with its customers does not invoke NGPA Section 504(a) which bars the producer from collecting in excess of the MLP. Thus, the fact that customer and the pipeline can agree how the NGPA refund should be treated does not mean that the pipeline and producer can agree that the producer can receive more than the MLP.

31. The Commission is entrusted with enforcing the NGPA, and the Court has directed that the overcharges resulting from the illegal ad valorem add-on is to be refunded to customers. Here Burlington admits it received more than the MLP in the sale of gas, and Commission precedent requires that it refund the amount to the pipeline. Moreover, Northern's customers and affected state commissions have not agreed to waiver of Burlington's entire refund obligation. If it believes that in the 1989 Settlement the pipeline agreed to make the refund, it can assert that claim in a court action against the pipeline.¹¹ However, that is not a basis for not paying the refund to the pipeline in the first instance.

32. We also find no merit in Burlington's argument that the denial of adjustment relief was arbitrary and capricious. Burlington requested that relief for the same reasons it advanced for not being liable for the refund. Since the Commission has rejected those arguments and held Burlington liable for the refund, it followed that Burlington could not be relieved of the obligation for the very same reasons. Moreover, Burlington did not show that it would suffer any hardship as a result of paying the refund.

¹¹See *Anadarko*, 85 FERC at 61,333.

The Commission orders:

Burlington's request for rehearing is denied.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.