

138 FERC ¶ 61,175  
UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

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

Texas Gas Transmission, LLC

Docket No. RP11-1999-002

ORDER ON REHEARING

(Issued March 15, 2012)

1. This order addresses a request for rehearing of the Commission's July 13, 2011 order<sup>1</sup> filed by the Western Tennessee Municipal Group, Jackson Energy Authority, City of Jackson, Tennessee, and the Kentucky Cities (collectively, Cities)<sup>2</sup> in the above referenced matter. In the July 13 Order, the Commission, among other things, lifted the suspension of certain tariff records imposed by the Commission's May 13, 2011 order in this proceeding.<sup>3</sup> Specifically, the Commission's May 13 Order accepted and suspended Texas Gas Transmission, LLC's (Texas Gas) proposed revisions to its tariff addressing the process by which Texas Gas may seek discount-type adjustments for negotiated rate

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<sup>1</sup> *Gulf South Pipeline, LP, et al.*, 136 FERC ¶ 61,029 (2011) (July 13 Order).

<sup>2</sup> The Western Tennessee Municipal Group consists of the following municipal distributor-customers of Texas Gas: City of Bells, Gas & Water, Bells, Tennessee; Brownsville Utility Department, City of Brownsville, Brownsville, Tennessee; City of Covington Natural Gas Department, Covington, Tennessee; Crockett Public Utility District, Alamo, Tennessee; City of Dyersburg, Dyersburg, Tennessee; First Utility District of Tipton County, Covington, Tennessee; City of Friendship, Friendship, Tennessee; Gibson County Utility District, Trenton, Tennessee; Town of Halls Gas System, Halls, Tennessee; Humboldt Gas Utility, Humboldt, Tennessee; Martin Gas Department, Martin, Tennessee; Town of Maury City, Maury City, Tennessee; City of Munford, Munford, Tennessee; City of Ripley Natural Gas Department, Ripley, Tennessee. The Kentucky Cities are the Cities of Carrollton and Henderson, Kentucky.

<sup>3</sup> *Gulf South Pipeline, LP, et al.*, 135 FERC ¶ 61,129 (2011) (May 13 Order).

agreements during future rate proceedings. For the reasons discussed below, the Commission denies Cities' request for rehearing of the July 13 Order.

**I. Background**

**A. April 13 Filing and May 13 Order**

2. On April 13, 2011, Texas Gas filed proposed revisions to its tariff which would allow Texas Gas to seek a discount adjustment for negotiated rate agreements if it (1) meets the standards required of an affiliate discount adjustment, including providing that any discount granted is required to meet competition, and (2) demonstrates that the adjustment does not have an adverse impact on recourse rate shippers. Specifically, Texas Gas proposed adding the following language to its tariff:

Treatment of Discounts:

(1) A discount-type adjustment to recourse rates for negotiated rate agreements shall only be allowed to the extent that Texas Gas can meet the standards required of an affiliate discount-type adjustment including requiring that Texas Gas shall have the burden of proving that any discount granted is required to meet competition.

(2) Texas Gas shall be required to demonstrate that any discount-type adjustment for negotiated rate agreements does not have an adverse impact on recourse rate shippers.

(a) Demonstrating that, in the absence of Texas Gas' entering into such negotiated rate agreement providing for such discount, Texas Gas would not have been able to contract for such capacity at any higher rate, and that recourse rates would otherwise be as high or higher than recourse rates which result after applying the discount adjustment; or

(b) Making another comparable showing that the negotiated rate discount contributes more fixed costs to the system than could have been achieved without the discount.

(3) Texas Gas may also seek to include in a discount-type adjustment for negotiated rate agreements that were converted from pre-existing discounted Part 284 agreements to negotiated rate agreements. Such adjustment would be based on the greater of: (i) the negotiated rate revenues received or (ii) the discounted recourse rate revenues which otherwise would have been received.

Texas Gas asserted that, except for minor, non-substantive changes to conform to its tariff conventions, the proposed tariff provisions are the same as the provisions accepted by the Commission in *Columbia Gulf*<sup>4</sup> and *WIC II*.<sup>5</sup> Finally, Texas Gas argued that, as the Commission recognized in *Columbia Gulf*, the proposed language “does not guarantee [the pipeline] the right to make a discount-type adjustment, but only establishes the burden of proof [the pipeline] must satisfy in order to obtain a discount-type adjustment consistent with the policy in *WIC [II]*.”<sup>6</sup>

3. Several parties, including Cities, protested Texas Gas’ proposed tariff amendment regarding discount adjustments for negotiated rate agreements. Cities argued that Texas Gas’ negotiated rate proposal is based on two Commission orders (i.e. *Columbia Gulf* and *WIC II*) that inexplicably contradict longstanding Commission policy established by the Commission in *Enbridge Pipelines (KPC)*,<sup>7</sup> *El Paso Natural Gas Co.*,<sup>8</sup> and *Nornew Energy Supply, Inc.*<sup>9</sup> and should not provide the basis for a decision in this proceeding. Cities also contended that Texas Gas’ proposal should be rejected because it would harm captive customers. Finally, Cities stated that, if the Commission accepted Texas Gas’ proposal, the Commission should clarify that the new provision will not apply to pre-existing negotiated rate agreements.

4. Texas Gas replied that its proposed language does not prejudice whether the Commission will ultimately allow Texas Gas, in a future rate case, to make a particular discount-type adjustment related to negotiated rate contracts. Texas Gas argued that approval of this provision only authorizes Texas Gas to present evidence in support of making such a discount-type adjustment in a future rate case.

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<sup>4</sup> Texas Gas Transmittal at 2 (citing *Columbia Gulf Transmission Co.*, 133 FERC ¶ 61,078 (2010) (*Columbia Gulf*)).

<sup>5</sup> *Id.* (citing the Commission’s November 2006 order in *Wyoming Interstate Co., Ltd.*, 117 FERC ¶ 61,150 (2006) (*WIC II*). That order partially granted rehearing of, accepted the pipeline’s filing to comply with, the Commission’s May 2006 order in *Wyoming Interstate Co., Ltd.*, 115 FERC ¶ 61,238 (2006) (*WIC I*)).

<sup>6</sup> *Id.* 3 (citing *Columbia Gulf*, 133 FERC ¶ 61,078 at P 15).

<sup>7</sup> Cities Protest at 4-6 (citing 103 FERC ¶ 61,305 (2003) (*Enbridge*)).

<sup>8</sup> *Id.* (citing, 114 FERC ¶ 61,305 (2006) (*El Paso*)).

<sup>9</sup> *Id.* (citing, 116 FERC ¶ 61,192 (2006) (*Nornew*)).

5. In the May 13 Order, the Commission stated, among other things, that the protests to Texas Gas filing had raised a number of issues concerning the circumstances by which pipelines should be permitted to adjust their rate design volumes based on negotiated rate transactions. Therefore, the Commission stated that it would address these issues in a subsequent order and the Commission accepted and suspended Texas Gas' proposed tariff records.

**B. Tennessee Order and July 13 Order**

6. Following the Commission's May 13 Order in this proceeding, the Commission issued an order in *Tennessee Gas Pipeline Co.*,<sup>10</sup> that, among other things, accepted Tennessee Gas' proposed changes to its tariff governing the condition by which the pipeline may seek a discount-type adjustment for certain negotiated rate agreements.<sup>11</sup> In *Tennessee*, the Commission addressed its policies regarding discount adjustments for negotiated rate transactions and explained its reasons and caveats for accepting tariff language consistent with *WIC II*,<sup>12</sup> *Columbia Gulf*,<sup>13</sup> and the tariff language proposed by Texas Gas in this case.

7. Subsequently, in this proceeding, the Commission issued the July 13 Order, which lifted the suspension of Texas Gas' tariff records and made them effective the date of the order. The Commission found that, given the recent decision in *Tennessee* regarding discount-type adjustments for negotiated rate agreements, Texas Gas' proposed tariff provisions were consistent with Commission policy and subsequent Commission orders.<sup>14</sup> The Commission stressed, however, as stated in *Tennessee* and *Columbia Gulf*, the Commission's acceptance of the tariff language did not guarantee the pipeline the

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<sup>10</sup> *Tennessee Gas Pipeline Co.*, 135 FERC ¶ 61,208 (2011) (*Tennessee*) (The Commission will use the term "Tennessee Gas" when referring to the name of the pipeline itself, as opposed to the *Tennessee* order.).

<sup>11</sup> During the course of the *Tennessee* proceeding, Tennessee Gas agreed to revise the tariff language to include the word "only" to make its proposal essential identical to the provisions accepted in *Columbia Gulf*. *Tennessee*, 135 FERC ¶ 61,208 at P 160. Texas Gas' proposal conforms with *Columbia Gulf*'s.

<sup>12</sup> *WIC II*, 117 FERC ¶ 61,150.

<sup>13</sup> *Columbia Gulf*, 133 FERC ¶ 61,078.

<sup>14</sup> *Transwestern Pipeline Co.*, 135 FERC ¶ 61,220 (2011); *Rockies Express Pipeline LLC*, 135 FERC ¶ 61,206 (2011).

right to make a discount-type adjustment, but only established the burden of proof the pipeline must satisfy in order to obtain a discount-type adjustment consistent with the policy in *WIC II* and *Columbia Gulf*.<sup>15</sup> Consistent with *Tennessee*, the Commission found that the burden set forth in Texas Gas' proposed tariff language provided a reasonable framework for considering the issue of discount-type adjustments for negotiated rates in Texas Gas' future general Natural Gas Act (NGA) section 4 rate cases. Finally, the Commission explained that it will address requests for discount-type adjustments involving negotiated rates as they arise in particular rate filings.<sup>16</sup>

8. On August 12, 2011, Cities filed a request for rehearing of the July 13 Order regarding the Commission's decision to approve Texas Gas' tariff revisions permitting the pipeline to seek discount-type adjustments for negotiated rate agreements. In support of rehearing, Cities assert that the Commission failed to explain its departure from prior precedent limiting the situations in which a pipeline may seek discount adjustments for negotiated rates. Cities also argue that the Commission's decision to give Texas Gas the unilateral right to seek adjustments to recourse rates based on negotiated rate agreements fails to give appropriate weight to the interest of customers and improperly shifts the burden of proof to customers on the issue of whether Texas Gas should be permitted to keep revenues from negotiated rates in excess of the recourse rate.

## **II. Discussion**

9. For the reasons discussed more fully below, the Commission denies Cities' request for rehearing of the July 13 Order's decision on Texas Gas' proposal on discount-type adjustments for negotiated rate agreements. Texas Gas' proposed tariff language does not guarantee it the right to make a discount-type adjustment, but only establishes the burden of proof Texas Gas must satisfy in order to obtain a discount-type adjustment for negotiated rate transactions in a future section 4 rate case. The Commission finds that the burden set forth in Texas Gas' proposed tariff language provides an appropriate framework for considering the issue of discount-type adjustments for negotiated rates in section 4 rate cases, consistent with our longstanding concern that negotiated rate transactions not cause inappropriate cost-shifting to recourse rate-paying shippers.

10. Before addressing Cities' contentions on rehearing, we will first describe the origins of, and reasons for, our policy of permitting billing determinants associated with discounted rate transactions to be adjusted downward for purposes of determining rate

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<sup>15</sup> See July 13 Order, 136 FERC ¶ 61,029 at P 5 (citing *Tennessee*, 135 FERC ¶ 61,208 at P 208; *Columbia Gulf*, 133 FERC ¶ 61,078 at P 15).

<sup>16</sup> *Id.*

design volumes in section 4 rate cases. We then review the Commission's past holdings concerning the burden pipelines must satisfy to obtain a discount adjustment for negotiated rates. Next, we explain why we are unwilling to impose a blanket prohibition on such adjustments for negotiated rate transactions as requested by Cities on rehearing, and find that Texas Gas' proposed tariff language provides a reasonable framework for considering whether to allow a discount adjustment for negotiated rates in a section 4 rate case.

**A. Discount Adjustment Policy**

11. As part of Order No. 436, which commenced the transition to open access transportation in 1985, the Commission adopted regulations permitting pipelines to engage in selective discounting based on the varying demand elasticities of the pipeline's customers.<sup>17</sup> Under these regulations, the pipeline is permitted to offer discounts from its maximum transportation rates, on a not unduly discriminatory basis, in order to meet competition. In Order No. 436, the Commission explained that these 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 found 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.<sup>18</sup>

12. In *Associated Gas Distributors v. FERC (AGD I)*,<sup>19</sup> the court upheld the regulations permitting selective discounting adopted in Order No. 436. In doing so, the court addressed an argument presented by some pipelines that the Commission's policy might lead to the pipelines under-recovering their costs. The court set forth a numerical example showing that the pipeline could under-recover its costs, if, in the next rate case after a pipeline obtained throughput by giving discounts, the Commission nevertheless

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<sup>17</sup> *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).

<sup>18</sup> See *Interstate Natural Gas Pipeline Rate Design*, 47 FERC ¶ 61,295, at 62,056-57, order on reh'g, 48 FERC ¶ 61,122, at 61,448-49 (1989) (*Rate Design Policy Statement*); and *Policy for Selective Discounting By Natural Gas Pipelines*, 111 FERC ¶ 61,309 (*Policy Reaffirmance Order*), order on reh'g, 113 FERC ¶ 61,173, at PP 3-4 (2005) (*Policy Reaffirmance Rehearing Order*).

<sup>19</sup> 824 F.2d 981, 1010-12 (D.C. Cir. 1987).

designed the pipeline's rates based on the full amount of the discounted throughput, without any adjustment. However, the court found no reason to fear that the Commission would employ this "dubious procedure,"<sup>20</sup> and accordingly rejected the pipelines' contention.

13. Consistent with *AGD I*, the Commission held in its 1989 *Rate Design Policy Statement*<sup>21</sup> that it would allow adjustments to discounted volumes in section 4 rate cases. 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. Therefore, in section 4 rate cases, pipelines may reduce the discounted volumes used to design its rates so that, assuming market conditions require it to continue giving the same level of discount when the new rates are in effect, the pipeline will be able to recover 100 percent of its cost of service. That reduction in the volumes used to design a pipeline's rates in a section 4 rate case is known as a "discount adjustment."

14. Since the *Rate Design Policy Statement*, pipelines have proposed discount adjustments in numerous section 4 rate cases.<sup>22</sup> While the pipeline has the ultimate burden of showing that its discounts were required to meet competition in order to obtain such an adjustment, the Commission has developed a policy in those cases of distinguishing between the burden of proof the pipeline must meet depending upon whether a discount was given to a non-affiliate or an affiliate. In the case of discounts to non-affiliated shippers, the Commission has stated that it is a reasonable presumption that

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<sup>20</sup> *Id.*

<sup>21</sup> *Rate Design Policy Statement*, 47 FERC ¶ 61,295.

<sup>22</sup> See, e.g., *Southern Natural Gas Co.*, 65 FERC ¶ 61,347, at 62,829-33 (1993), *reh'g denied*, 67 FERC ¶ 61,155, at 61,456-60 (1994); *Williston Basin Interstate Pipeline Co.*, 67 FERC ¶ 61,137, at 61,377-82 (1994); *Panhandle Eastern Pipe Line Co.*, Opinion No. 395, 71 FERC ¶ 61,228, at 61,866-71 (1995); *Northwest Pipeline Corp.*, 71 FERC ¶ 61,253, at 62,007-09 (1995); *Panhandle Eastern Pipe Line Co.*, Opinion No. 404, 74 FERC ¶ 61,109, at 61,399-08 (1996); *Williams Natural Gas Co.*, 77 FERC ¶ 61,277, at 62,205-07 (1996), *reh'g denied*, 80 FERC ¶ 61,158, at 61,189-90 (1997) (*Williams*); *Iroquois Gas Transmission Sys., L.P.*, 84 FERC ¶ 61,086, at 61,478 (1998), *reh'g denied*, 86 FERC ¶ 61,261 (1999) (*Iroquois*); *Williston Basin Interstate Pipeline Co.*, 84 FERC ¶ 61,266, at 61,401-02 (1998); *Northwest Pipeline Corp.*, 87 FERC ¶ 61,266, at 62,077 (1999); and *Trunkline Gas Co.*, 90 FERC ¶ 61,017, at 61,084-96 (2000) (*Trunkline*).

a pipeline will always seek the highest possible rate from non-affiliated shippers, because it is in its 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.<sup>23</sup>

15. In contrast to its treatment of non-affiliate discounts, the Commission has consistently held that “the pipeline has a heavy burden to show that competition required discounts to affiliates.”<sup>24</sup> In Opinion No. 404,<sup>25</sup> the Commission held that the pipeline had not met its burden to show that its discounts to its affiliates were required by competition. While the pipeline did show that it had granted some non-affiliates similar discounts, the Commission held that this was not sufficient. Rather, the Commission stated that the pipeline should have identified the specific competitive alternatives the affiliate had, which required giving the discount. In addition, in *Williams*<sup>26</sup> and *Trunkline*,<sup>27</sup> the Commission disallowed discount adjustments in connection with a discount to an affiliate on similar grounds.

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<sup>23</sup> While the Commission has generally permitted a discount adjustment with respect to non-affiliate transactions, the Commission has held that, when a pipeline gives a long-term discount to non-affiliated firm shippers, it would expect that the pipeline would make a thorough analysis whether competition required such a long-term discount. In two cases, the Commission held that the pipeline had failed to present any evidence of such an analysis. *Iroquois Gas Transmission System, L.P.*, 84 FERC ¶ 61,086, at 61,476-78 (1998), *reh'g denied*, 86 FERC ¶ 61,261 (1999); *Trunkline Gas Co.*, 90 FERC ¶ 61,017 at 61,092-95 (2000).

<sup>24</sup> *Trunkline Gas Co.*, 90 FERC at 61,087 and 61,096 (describing the type of evidence the pipeline must submit to satisfy this burden).

<sup>25</sup> 74 FERC at 61,401-61,402.

<sup>26</sup> 77 FERC at 62,206-61,207.

<sup>27</sup> 90 FERC at 61,096.

**B. The Commission's Past Treatment of Discount-Type Adjustments for Negotiated Rates**

16. The Commission adopted its negotiated rate program in its 1996 *Alternative Rate Policy Statement*.<sup>28</sup> Under that program, the Commission permits pipelines to negotiate individualized rates which, unlike discounted rates,<sup>29</sup> are not constrained by the maximum and minimum rates in the pipeline's tariff.<sup>30</sup> However, pipelines must permit shippers to opt for use of the traditional cost-of-service "recourse rates" in the pipeline's tariff, instead of requiring them to negotiate rates for any particular service. The Commission relies on the availability of the recourse rates to prevent pipelines from exercising market power by assuring that the customer can fall back to the just and reasonable tariff rate if the pipeline unilaterally demands excessive prices or withholds service.<sup>31</sup>

17. While the Commission's discount adjustment policies had been fully developed by 1996, the *Alternative Rate Policy Statement* did not address the issue of whether similar adjustments would be permitted for negotiated rate transactions in future pipeline rate cases. Instead the Commission stated:

Issues regarding the appropriate allocation of costs between recourse rate shippers and negotiated rate shippers will be addressed fully in the pipeline's section 4 rate cases. At that time, the Commission will consider issues related to cross subsidization and interested parties will be able to raise any concerns they have regarding the proper allocation of costs. Therefore, the Commission does not intend to review a pipeline's negotiated rates at the time filed.<sup>32</sup>

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<sup>28</sup> *Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines*, 74 FERC ¶ 61,076, *order granting clarification*, 74 FERC ¶ 61,194, *reh'g denied*, 75 FERC ¶ 61,024 (1996) (Alternative Rate policy Statement).

<sup>29</sup> *See* 18 C.F.R. § 284.10(c)(5) (2011) ("any rate schedule filed under this section must state a maximum and a minimum rate.").

<sup>30</sup> *See Northern Natural Gas Co.*, 105 FERC ¶ 61,299 (2003) (clarifying the distinction between discounted and negotiated rates).

<sup>31</sup> *Alternative Rate Policy Statement*, at 61,238-42.

<sup>32</sup> *Id.* 61,242.

In denying rehearing of the *Alternative Rate Policy Statement*, the Commission again set forth its intention to address issues related to the use of negotiated rates on a case by case basis.<sup>33</sup>

18. After adoption of the *Alternative Rate Policy Statement*, individual pipelines began filing tariff language authorizing them to negotiate rates. Some pipelines indicated that they reserved the right in subsequent section 4 rate cases to seek such an adjustment. While the Commission initially stated that issue should be addressed in individual section 4 rate cases,<sup>34</sup> the Commission subsequently modified that determination. In a series of orders issued in November 1997, the Commission explained its policy on this issue as follows:

The Commission's policy with respect to negotiated rates is that "customers electing the recourse rates will be no worse off as a result of the use of negotiated rates." Although the Commission is not promulgating a *per se* rule against discount-type adjustments to recourse rates to reflect negotiated rates, the Commission does require that a pipeline's negotiated rate proposal protect the recourse rate-paying shippers against inappropriate cost-shifting.

Pipelines assert that there may be times when negotiated rates could benefit recourse rate shippers. However, such instances

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<sup>33</sup> As the Commission explained in denying rehearing of the policy statement:

The purpose of the Policy Statement was to provide the industry with guidance by stating the criteria the Commission will consider when evaluating the proposals for alternative ratemaking methodologies. ... **The Commission intends to evaluate the specific proposals based on the facts and circumstances relevant to each applicant and to address any concerns regarding the application of the criteria on a case-by-case basis.** In general, objections to statements of policy are not directly reviewable. Rather, such review must await implementation of the policy in a specific case. (emphasis supplied)

*Alternative Rate Policy Statement*, 75 FERC at 61,076 (emphasis supplied).

<sup>34</sup> See, e.g., *NorAm Gas Transmission Co.*, 75 FERC ¶ 61,091 (1996) (*NorAm*).

are hypotheticals that lack any certainty or mechanism to ensure that such negotiated rate transactions would be beneficial and not harmful to recourse rate shippers. Since the inception of the Commission's negotiated rate policy, the Commission has made clear its intention to keep recourse shippers from being adversely affected. Thus, without protective measures in place, the Commission will not permit discount adjustments for negotiated rates.

While retaining and attracting new load is an important goal, the Commission considers that this goal must be achieved in manner that adequately protects existing shippers. Negotiated rates are a new voluntary option available to pipelines that does not preclude the pipeline discounting rates to attract or retain load. However, when a pipeline chooses to use the new authority to negotiate new rate forms (such as index rates or non-SFV rates), the Commission must be assured that no harm will occur to the shippers still taking service using the existing form of rates. NorAm has not provided this assurance regarding its negotiated rates program. Thus, the Commission continues to hold that in order to ensure that the risks involved in NorAm's negotiating rates do not fall on its recourse shippers, no discount-type adjustment will be allowed for negotiated rates in NorAm's next rate case.<sup>35</sup>

19. Subsequent to its actions in *NorAm* and related cases, the Commission found in *Northwest* that the pipeline had provided adequate assurances to protect the recourse rate shipper and the Commission, therefore, accepted Northwest's proposal to include in its tariff a mechanism under which it could seek a discount-type adjustment in a future section 4 rate case for negotiated rate transactions.<sup>36</sup> Under Northwest's proposal, it was not permitted to seek a discount adjustment in a future rate case for a negotiated rate, unless it first discounted the recourse rate and then subsequently converted the discount

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<sup>35</sup> *NorAm*, 82 FERC at 61,872 (internal citations omitted). See also *Wyoming Interstate Co., Ltd.*, 90 FERC ¶ 61,220, at 61,720 (2000); *CNG Transmission Corp.*, 82 FERC ¶ 61,401, at 62,328 (1997); *Tennessee Gas Pipeline Co.*, 81 FERC ¶ 61,207, at 61,880 (1997); *Columbia Gulf Transmission Co.*, 81 FERC ¶ 61,206, at 61,876 (1997); *Koch Gateway Pipeline Co.*, 81 FERC ¶ 61,205, at 61,874 (1997).

<sup>36</sup> *Northwest Pipeline Corp.*, 79 FERC ¶ 61,416 (1997), *order on reh'g*, 84 FERC ¶ 61,109 (1998) (*Northwest*).

to a negotiated rate. The discount adjustment would then be based on the higher of the negotiated rate revenues actually received by Northwest or the discounted recourse rate revenues that would have been received absent the conversion to a negotiated rate contract. Moreover, Northwest would be required to show that competition required the discount without the benefit of any presumption that the discount was given to meet competition.

20. In 2000, in *Southern*, the Commission addressed another proposed tariff provision setting forth the conditions under which a pipeline could seek a discount-type adjustment for negotiated rates in a future section 4 rate case. The Commission rejected that proposal, holding that it failed to provide protections for recourse rate shippers comparable to those provided by the pipeline in *Northwest*.<sup>37</sup> However, the Commission stated that:

the proper place to review whether recourse rate customers have in fact been protected is in a section 4 rate proceeding. All parties will be free to argue whether the pipeline has adequately protected the recourse rate customers. That is the fairest way to accommodate the interests of all concerned, including the pipeline. **Upon reflection of the various orders heretofore entered by the Commission, it is clear that this course of action better serves the ends of just and reasonable rates and practices than does a predetermination, not based on facts, whether a given plan is adequate.** Therefore, we affirm our holding in the April 12 Order that Southern's proposed plan is inadequate, and we also affirm our determination that Southern may seek discount-rate adjustments in a future rate case where all the facts are available for reasoned decision on whether there has in fact been a cost-shifting. The burden of proof, of course, will be Southern's to show that such a shifting has not occurred.<sup>38</sup>

21. As Cities point out in its rehearing request, after *Southern*, the Commission issued orders in 2003,<sup>39</sup> March 2006,<sup>40</sup> and August 2006,<sup>41</sup> finding that three pipelines'

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<sup>37</sup> *Southern Natural Gas Co.*, 94 FERC ¶ 61,063 (2001); *Southern Natural Gas Co.*, 95 FERC ¶ 61,038, *order on reh'g*, 95 FERC ¶ 61,364 (2001) (*Southern*).

<sup>38</sup> *Southern*, 95 FERC at 62,379 (emphasis added).

<sup>39</sup> *Enbridge*, 103 FERC ¶ 61,305 at PP 17-18.

proposed tariff provisions defining when they could seek a discount-type adjustment for negotiated rate transactions were overbroad. Citing *Northwest*, the Commission stated in those orders that it had permitted pipelines to include tariff language permitting such adjustments “in the limited situation where the pipeline agrees to a discounted rate with a shipper and then converts it to a negotiated rate,”<sup>42</sup> and the Commission required the pipelines to modify their provisions consistent with that policy. In none of those orders, did the Commission refer to its statement in *Southern* that, even without any tariff language concerning discount adjustments for negotiated rate transactions, the pipeline could seek such an adjustment in a future rate case. Neither Enbridge nor Nornew sought rehearing of the orders in their cases. El Paso sought rehearing of the Commission’s ruling in its case, but that rehearing was subsequently dismissed as moot after the Commission approved a settlement of El Paso’s rate case.<sup>43</sup>

22. In May 2006, shortly after the March 2006 *El Paso* order described in the preceding paragraph, the Commission issued an order, finding that WIC’s existing tariff provision concerning discount-type adjustments for negotiated rate transactions did not conform to Commission policy.<sup>44</sup> That tariff provision stated that WIC could seek a discount-type adjustment in a section 4 rate case whenever the negotiated rate is below the recourse rate, subject to these requirements: (1) that WIC satisfy the standards required for affiliate discount adjustments; and (2) that WIC show the adjustment does not have an adverse impact on recourse rate shippers. The Commission held that this provision failed to comply with the policy set forth in *El Paso* that discount adjustments for negotiated rates are prohibited, except in the limited situation where the pipeline agrees to a discounted rate with a shipper and then converts it to a negotiated rate. Therefore, the Commission directed WIC to either modify its tariff consistent with Commission policy or explain why it should not be required to do so.

23. WIC requested rehearing of the Commission’s May 2006 *WIC I* order, contending that the Commission had erred in characterizing its policy as imposing a *per se*

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<sup>40</sup> *El Paso*, 114 FERC ¶ 61,305 at PP 302-3.

<sup>41</sup> *Nornew*, 116 FERC ¶ 61,192 at PP 57-58. In all three orders, the Commission cited *Northwest*.

<sup>42</sup> *Enbridge*, 103 FERC ¶ 61,305 at P 17; *El Paso*, 114 FERC ¶ 61,305 at P 302; *Nornew*, 116 FERC ¶ 61,192 at P 57.

<sup>43</sup> *El Paso Natural Gas Co.*, 121 FERC ¶ 61,266 (2007).

<sup>44</sup> *WIC I*, 115 FERC ¶ 61,238 at PP 7-13.

prohibition on discount-type adjustments for negotiated rate transactions, unless the negotiated rate contract was first entered into as a discounted recourse rate agreement. WIC also submitted a compliance filing, proposing to modify its tariff provision to state that it would only be permitted a discount adjustment for negotiated rate transactions, if it could satisfy the same burden of proof as the Commission requires pipelines to meet in order to obtain a discount adjustment for discounts granted to affiliates. In addition, the compliance filing required WIC to demonstrate that any discount type adjustment does not have an adverse impact on recourse rate shippers by (1) showing that, in the absence of WIC's entering into such negotiated rate agreements, WIC would not have been able to contract for such capacity at any higher rate(s) and that recourse rates would otherwise be as high or higher than recourse rates which result after applying the discount adjustment, or (2) making another comparable showing that the negotiated rate contributes more to fixed cost recovery to the system than could have been achieved without the negotiated rate.

24. In November 2006, the Commission issued its order in *WIC II*, partially granting rehearing and clarification of *WIC I* and accepting WIC's compliance filing. In that order, the Commission clarified that there is no *per se* prohibition against discount-type adjustments for negotiated rates. The Commission pointed out that in the *NorAm* series of orders in November 1997, quoted above, the Commission had stated that, although it was not promulgating a *per se* rule against discount-type adjustments to recourse rates to reflect negotiated rates, the Commission required that a pipeline's negotiated rate proposal protect the recourse rate-paying shippers against inappropriate cost-shifting. The Commission stated that this remained the Commission's policy, summarizing the policy as follows:

Thus, the Commission does not have a *per se* prohibition on discount-type adjustments with respect to negotiated rates. However, in order for a pipeline to seek such a discount adjustment in its next rate case, the pipeline must include in the negotiated rate provisions of its tariff a protective mechanism that will ensure that its negotiated rate transactions will not cause any inappropriate cost shifting to the recourse rate shippers.<sup>45</sup>

25. The Commission reaffirmed that WIC's existing tariff provision did not satisfy this policy, because it provided that WIC could seek a discount adjustment for negotiated rate transactions "*whenever* the rate for service is below the posted maximum rate."<sup>46</sup>

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<sup>45</sup> *WIC II*, 117 FERC ¶ 61,150 at P 11.

<sup>46</sup> *Id.* P 13.

The Commission interpreted this language as permitting WIC to seek a discount adjustment for all transactions with negotiated rates below the maximum recourse rate, without regard to whether it had other negotiated rate transactions with rates in excess of the maximum recourse rate. The Commission stated that this approach:

illustrates one of the Commission's primary concerns about discount adjustments for negotiated rates. That is, because negotiated rates, unlike discounted rates, can be above, as well as below, the maximum recourse rate, pipelines should not be able to shift the cost of below maximum rate discounts to the recourse rate shippers, while keeping the profits from above maximum rate negotiated rate transactions for themselves.<sup>47</sup>

26. The Commission stated that the *Northwest* mechanism minimizes this risk, because the only negotiated rate transactions that can qualify for a discount adjustment are transactions that started out as discounts below the maximum rate. The *Northwest* mechanism then assures that recourse rate shippers can receive the upside benefit, if the negotiated rate enables the pipeline to recover more than it would have under the discounted rate, since any discount adjustment would be based on the higher of the discounted rate or the negotiated rate. The Commission concluded that there is no *per se* rule against discount adjustments for negotiated rate transactions. However, in order to obtain such an adjustment the pipeline must have a tariff provision protecting recourse rate shippers from inappropriate cost-shifting, including shifting the cost of below maximum rate negotiated rate transactions to recourse rate shippers, while the pipeline retains the profits from above maximum rate negotiated rate transactions.

27. When addressing WIC's compliance filing, the Commission found that, while WIC's existing tariff provision was contrary to Commission policy, WIC's revised tariff language adequately protected recourse rate shippers against inappropriate cost shifting. The Commission accordingly approved the revised tariff provision, despite the fact that, unlike the *Northwest* mechanism, it did not limit such adjustments to the situation where the pipeline converts a previously agreed-upon discounted rate to a negotiated rate.

28. While *WIC II* did not include a full explanation of why WIC's revised tariff language provided sufficient protections to recourse rate shippers, the Commission provided a fuller explanation, when it accepted an essentially identical tariff provision in *Columbia Gulf*.<sup>48</sup> The Commission explained that the tariff language required the pipeline to satisfy the same heavy burden pipelines must bear with respect to affiliate

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<sup>47</sup> *Id.*

<sup>48</sup> *Columbia Gulf*, 133 FERC ¶ 61,078 at P 14.

discounts to show that competition required the discount. Second, the tariff language specifically required the pipeline to demonstrate that any discount-type adjustment “does not have an adverse impact on recourse rate shippers.” The Commission also pointed out that, when the pipeline files its next general section 4 rate proceeding, shippers would have the opportunity to fully evaluate all of the pipeline’s cost and revenue data and make any arguments as to whether the pipeline has satisfied its heavy burden of proof and shown that recourse rate shippers are not adversely affected. Among other things, shippers can raise the issue whether any proposed discount-type adjustment is consistent with the policy that “pipelines should not be able to shift the cost of below maximum rate discounts to the recourse rate shippers, while keeping the profits from above maximum rate transactions for themselves.”<sup>49</sup>

29. No party sought rehearing of either the *WIC II* or *Columbia Gulf* orders.

**C. Revised Policy on Discount Adjustments for Negotiated Rates**

30. In *Tennessee*, the pipeline proposed, in a general section 4 rate case, a tariff provision concerning discount-type adjustments for negotiated rate transactions, which was essentially the same as the provisions approved in *WIC II* and *Columbia Gulf*. Numerous parties, including the American Gas Association, protested the pipeline’s proposal. In order to fully consider the policy issues raised by the protests, the Commission included Tennessee Gas’ proposal among the issues to be discussed at the technical conference in that proceeding.

31. In its May 2011 order on the *Tennessee* technical conference, the Commission reviewed its past precedent concerning the conditions a pipeline must satisfy in order to obtain a discount-type adjustment for negotiated rate transactions in a section 4 rate case. The Commission recognized that its policy on this issue “has evolved over the fifteen years since the negotiated rate program was established.”<sup>50</sup> The Commission has consistently reiterated its intent, set forth in the *Alternative Rate Policy Statement*, that “customers electing the recourse rates will be no worse off as a result of the use of negotiated rates.”<sup>51</sup> However, the Commission’s statements in individual cases concerning how to accomplish that goal have varied. In the November 1997 *NorAm* series of orders, the Commission reconsidered its initial policy of simply allowing the issue of how to allocate costs between recourse rate and negotiated rate shippers to be

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<sup>49</sup> *Id.* P 15.

<sup>50</sup> *Tennessee*, 135 FERC ¶ 61,208 at P 199.

<sup>51</sup> *Alternative Rate Policy Statement*, 74 FERC at 61,242.

addressed at hearing in section 4 rate cases. While the Commission stated it “was not promulgating a *per se* rule against discount-type adjustments to recourse rates to reflect negotiated rates,” the Commission held that, unless a pipeline’s negotiated rate tariff provisions included protections assuring that recourse rate-paying shippers would not be subject to inappropriate cost-shifting, the Commission would not permit discount-type adjustments for negotiated rates in the pipeline’s next rate case. Some parties in the *Tennessee* proceeding interpreted the *NorAm* line of cases as establishing a nearly blanket prohibition on pipelines seeking discount adjustments for negotiated rates in section 4 rate cases.<sup>52</sup> However, the Commission pointed out that in some later cases, including the *Southern*, *WIC II*, and *Columbia Gulf* orders described above, it had not imposed such a stringent burden.

32. After further considering the matter in response to the comments on following the technical conference, the May 2011 *Tennessee* order held that the approach it has taken in the *WIC II* and *Columbia Gulf* cases provides the most balanced and reasonable method of addressing this issue. The Commission found that a blanket prohibition on discount adjustments for negotiated rates is too extreme, because it fails to recognize that pipelines may use negotiated rates to obtain additional shippers who would not contract for service at the pipeline’s recourse rates. Such negotiated rate transactions can benefit the maximum rate recourse rate shippers in the same manner as discounted rate transactions by enabling the pipeline’s fixed costs to be spread over more units of services. In those circumstances, the considerations underlying our discount adjustment policy for discounted rate transactions, as set forth in the 1989 *Rate Design Policy Statement* and subsequent cases permitting discount adjustments, would also apply to negotiated rate transactions.

33. However, the Commission recognized that, unlike discounted rates, negotiated rates may exceed the maximum recourse rate. The Commission stated that this fact raises the possibility that a pipeline may enter into some negotiated rate transactions for reasons other than lowering the rate below its maximum recourse rate in order to meet competition and attract shippers who would not otherwise contract for service on the pipeline. For example, a pipeline may enter into a negotiated rate transaction using a formula rate based on gas price differentials, because it believes that the market value of its capacity as reflected in those pricing differentials during the term of the negotiated rate agreement may be higher than its maximum recourse rate. For that reason, the Commission has been concerned that pipelines should not be granted discount

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<sup>52</sup> The only exception from the prohibition would be for negotiated rate transactions converted from discounted rate transactions, as permitted in *Northwest*.

adjustments for below-maximum rate negotiated rate agreements without taking into account projected revenues from above-maximum rate negotiated rate agreements.<sup>53</sup>

34. In the May 2011 *Tennessee* order, the Commission held that *WIC II* had adopted a reasonable approach to the issue of how to address above-maximum rate negotiated rate agreements. Under that approach, each pipeline is given a choice of whether to include in its tariff a provision permitting a discount adjustment for negotiated rates. If the pipeline chooses not to have such a tariff provision, “there is no requirement for the pipeline to flow-through to recourse rate shippers any revenue the pipeline receives under a negotiated rate agreement in excess of recourse rate levels.”<sup>54</sup> In other words, in a section 4 rate case, the pipeline’s rates would be designed based on the assumption that all its negotiated rates were at the maximum recourse rate, even if during the test period the pipeline’s negotiated rate revenues exceeded its maximum recourse rates. As the Commission explained in *WIC II*, “Where there is no tariff provision permitting a discount adjustment, the risk of cost shifting does not exist; therefore, pipelines are entitled to keep the profits from negotiated rates above the maximum recourse rate.”<sup>55</sup>

35. However, if the pipeline does include in its tariff a provision permitting discount adjustments for negotiated rates, then a pipeline may obtain a discount adjustment for negotiated rate transactions, if it satisfies the burden of proving that the negotiated rates were required to meet competition and that the adjustment does not have an adverse impact on recourse rate shippers. The Commission stated that, as part of considering the effect of the adjustment on recourse rate shippers, parties may raise the issue “whether or not the pipeline should be allowed to keep negotiated revenues in excess of the recourse rate.”<sup>56</sup> The Commission explained in *Tennessee* that, if during the test period in a section 4 rate case, the rates for some negotiated rate transactions were in excess of the maximum recourse rate, the volumes associated with those transactions may be adjusted upward to allocate costs to those transactions based on the actual revenues received. This would prevent the pipeline from shifting the costs of below maximum rate negotiated rate transactions to the recourse rate shippers, while keeping the profits from above maximum rate negotiated rate transactions for itself.

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<sup>53</sup> *WIC II*, 117 FERC ¶ 61,150 at P 13.

<sup>54</sup> *Id.* P 15.

<sup>55</sup> *Id.*

<sup>56</sup> *Id.* P 14.

36. Thus, the Commission held that Tennessee Gas' proposed tariff language provides the pipeline an opportunity to obtain a discount adjustment for negotiated rate transactions entered into for the same purpose as the discounted rate transactions for which the Commission permits discount adjustments: to meet competition and thus benefit the maximum rate recourse rate shippers by enabling the pipeline's fixed costs to be spread over more units of services. The Commission found that, at the same time, the tariff language protects recourse rate shippers from unreasonable costs shifts in two ways.

37. First, in order to show that it gave the discount to meet competition, the pipeline must satisfy "the standards required of an affiliate discount-type adjustment." The Commission has consistently held that, in order to obtain a discount adjustment in connection with a discount provided to an affiliate, "the pipeline has a heavy burden to show that competition required discount to affiliates."<sup>57</sup> Thus, in order to obtain a discount adjustment for a negotiated rate, the pipeline will have to provide detailed evidence concerning the competitive circumstances which required it to offer a negotiated rate that was lower than its maximum recourse rate, including the competitive alternatives the negotiated rate shipper had.<sup>58</sup> Moreover, the Commission pointed out in *Tennessee* that most negotiated rate transactions are for long-term firm service. As with long-term firm discounted rate transactions, the Commission would expect that at the time of offering a below-maximum negotiated rate, the pipeline would make a thorough analysis whether competition required such a long-term commitment to a negotiated rate below the maximum recourse, and the Commission would expect that in a rate case seeking a discount adjustment for such a transaction, the pipeline would present evidence showing that it did make such an analysis.<sup>59</sup>

38. Second, the tariff language specifically requires the pipeline to demonstrate that any discount-type adjustment "does not have an adverse impact on recourse rate shippers." The Commission stated that, as part of considering whether the pipeline has satisfied that burden, the parties should evaluate all of the pipeline's cost and revenue data, including revenue from all its negotiated rate transactions. The analysis should not

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<sup>57</sup> *Trunkline*, 90 FERC at 61,087 and 61,096 (describing the type of evidence the pipeline must submit to satisfy this burden).

<sup>58</sup> See Opinion No. 404, 74 FERC at 61,401-02, holding that the pipeline had not met its burden to show that its discounts to its affiliates were required by competition, because it has not identified the specific competitive alternatives the affiliate had, which required giving the discount. See also *Williams*, 77 FERC at 62,206-07, and *Trunkline*, 90 FERC at 61,096.

<sup>59</sup> *Iroquois*, 84 FERC at 61,476-78; *Trunkline*, 90 at 61,092-95.

focus solely on the particular negotiated rate transactions for which the pipeline has sought a discount adjustment. Parties should also consider whether the pipeline obtained above-maximum rate revenues from other negotiated rate transactions which offsets the below-maximum rate revenues from the negotiated rate transactions for which the pipeline seeks a discount adjustment.<sup>60</sup> If so, there should be a corresponding reduction in any proposed discount adjustment. Moreover, if the pipeline's overall negotiated rate revenues exceeded its maximum recourse rates, parties may, as stated in *WIC II*, raise the issue whether costs should be allocated to the negotiated rate transactions based on the full revenues received in those transactions during the test period.

39. For these reasons, the Commission concluded in *Tennessee* that the tariff language approved in *WIC II* and *Columbia Gulf* provides a reasonable framework for considering in a general section 4 rate case whether to permit a discount adjustment for a pipeline's negotiated rate transactions. That tariff language accommodates the interests of all concerned, including the pipeline and its customers. At the hearing in the section 4 rate case, all parties will be free to present evidence and argue whether the pipeline has adequately protected the recourse rate customers. This should bring before the Commission all the facts about the relevant transactions for a reasoned decision on whether the negotiated rate transactions benefitted the recourse rate shipper or whether a discount adjustment would cause unreasonable cost-shifting. Such an approach better serves the ends of just and reasonable rates and practices than does a nearly blanket prohibition on any discount adjustments for negotiated rate transactions.<sup>61</sup> Therefore, in *Tennessee*, the Commission reaffirmed the policy adopted in *WIC II* and *Columbia Gulf*.

40. A number of parties requested rehearing of the Commission's order in *Tennessee*. However, thereafter the Commission approved a settlement of Tennessee Gas' section 4 rate case.<sup>62</sup> That settlement reserved certain issues for Commission decision; however, the settlement did not reserve any issue concerning discount adjustments for negotiated rate transactions for Commission decision.

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<sup>60</sup> *Columbia Gulf*, 133 FERC ¶ 61,078 at P 15 (citing *WIC II*, 117 FERC ¶ 61,150 at P 15).

<sup>61</sup> *See Southern*, 95 FERC at 62,379.

<sup>62</sup> *Tennessee Gas Pipeline Co., LLC*, 137 FERC ¶ 61,182 (2011).

**D. Cities' Contentions that the Commission's Reliance on *Tennessee* was Misplaced**

41. On rehearing, Cities contend that *Tennessee* and the July 13 Order erred in three respects. First, Cities assert that the Commission failed to explain its departure from prior policy limiting the situations in which a pipeline may seek discount adjustments for negotiated rates. Second, Cities contend that the revised policy announced in *Tennessee* improperly shifts the burden of proof to customers on the issue of whether Texas Gas should be permitted to keep revenues from negotiated rates in excess of the recourse rate and fails to give appropriate weight to the interest of customers. Third, Cities contend that the Commission improperly permitted Texas Gas to seek discount adjustments for negotiated rate transactions entered into before the effective date of its revised tariff provision. Below, we address these contentions in turn.

**1. Departure from Precedent**

**a. Cities' Argument**

42. Cities contend that, in both *Tennessee* and the July 13 Order in this proceeding, the Commission failed to explain its departure from prior precedent limiting the situations in which a pipeline may seek discount adjustments for negotiated rate transactions. Cities argue that an administrative agency may not depart from its own precedent without explanation<sup>63</sup> nor may it rely on prior decisions that similarly failed to address conflicting precedent.<sup>64</sup> Cities assert that the July 13 Order violated both of these tenets.

43. Cities contend that, in its protest of Texas Gas' tariff amendment, it cited three specific decisions – *Enbridge*, *El Paso*, and *Nornew* – in which the Commission held that the pipeline could only include a tariff provision permitting it to seek a discount adjustment for negotiated rates “in the *limited* situation where the pipeline agrees to a discounted rate with a shipper and then converts it to a negotiated rate.”<sup>65</sup> Cities contend that the pipeline in *El Paso* filed a tariff provision which would have permitted it to obtain a discount adjustment to the extent that it could meet the standards required of an

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<sup>63</sup> Cities Rehearing Request at 5 (citing *Ramaprakash v. FAA*, 346 F.3d 1121, 1124 (D.C. Cir. 2003)).

<sup>64</sup> *Id.* (citing *Hatch v. FERC*, 654 F.2d 825, 834 (D.C. Cir. 1981)).

<sup>65</sup> *Id.* (citing *Enbridge*, 103 FERC ¶ 61,305 at PP 17-18; *El Paso*, 114 FERC ¶ 61,305 at PP 302-303; *Nornew*, 116 FERC ¶ 61,192 at PP 57-58).

affiliate discount-type adjustment.<sup>66</sup> Cities aver that the Commission in March 2006, finding El Paso's proposal overly broad, mandated that the pipeline adhere to the standard, cited initially by the Commission in 2003 in *Enbridge*.<sup>67</sup> Cities state that this mandate was also subsequently upheld by the Commission in June 2006 in *Nornew*.

44. However, Cities state that, in its November 2006 *WIC II* decision, the Commission reached a different result. In *WIC II*, Cities allege that the Commission examined certain existing language in WIC's tariff and determined that it was "very similar to that filed by El Paso, which was also found to be overly broad."<sup>68</sup> Specifically, Cities state that the language in the then-existing WIC tariff would have permitted it to seek a discount adjustment for a negotiated rate agreement whenever the rate for service is below the posted maximum rate for service under the applicable rate schedule for all or part of the twelve-month base period and/or the nine-month adjustment period for such rate change proceeding. Cities aver that in its earlier order in *WIC I*, the Commission told the pipeline to revise its tariff or show cause why it should not have to do so.<sup>69</sup> Cities argue that, instead of revising its tariff to meet the *Enbridge* standard, WIC filed revised tariff language similar to Texas Gas' filing in the instant proceeding. Cities state that, without providing any explanation, in *WIC II*, the Commission accepted WIC's revised language and concluded that it "conforms with the Commission's policy for discount adjustments related to negotiated rate agreements."<sup>70</sup>

45. Cities argue that the decisions in *El Paso* and *WIC II* cannot be reconciled with each other and the Commission has not sought to do so.<sup>71</sup> Cities claim that the portion of

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<sup>66</sup> *Id.* 6.

<sup>67</sup> *Id.* (citing *Enbridge*, 103 FERC ¶ 61,305).

<sup>68</sup> *Id.* (citing *WIC II*, 117 FERC ¶ 61,150 at P 17).

<sup>69</sup> *Id.* 7 (citing *WIC I*, 115 FERC ¶ 61,238).

<sup>70</sup> *Id.* (citing *WIC II*, 117 FERC ¶ 61,150 at P 22.)

<sup>71</sup> Cities note that Texas Gas attempted to argue that the proposed tariff language in *El Paso* and *Nornew* (ultimately rejected by the Commission as overly broad) was different from the proposed tariff language accepted by the Commission in *WIC II*. However, Cities claim that this was an "apples-to-oranges" comparison because, in all three cases, the Commission rejected the language as overly broad. Cities argue that, while the Commission specifically directed the pipelines in *El Paso* and *Nornew* to add

the *Tennessee* order describing the Commission's precedent concerning discount adjustments for negotiated rate transactions skips over *Enbridge*, *El Paso*, and *Nornew*. Specifically, Cities allege that, immediately after discussing the *Southern* order that was issued in 2000, the Commission incorrectly states that it "next addressed the issue of permissible tariff provisions permitting a pipeline to seek discount adjustments for negotiated rates in a future rate case in [*WIC II*]." <sup>72</sup> Cities also assert that, more than a year after the Commission issued *WIC II*, it reaffirmed the decision developed in the *Enbridge* line of cases in *Texas Eastern*. <sup>73</sup> Cities argue that the Commission stated in *Texas Eastern* that, under its policy, "any revenue shortfall due to a negotiated rate lower than the incremental recourse rate cannot be recovered from existing shippers." <sup>74</sup> Hence, Cities aver that *WIC II* appears to be nothing more than an anomaly that pipelines have recently latched onto.

**b. Commission Decision**

46. We reject Cities' contention that the Commission has not adequately explained any departure from prior precedent concerning the circumstances in which pipelines may seek discount-type adjustments for negotiated rate transactions. In *Tennessee*, <sup>75</sup> the Commission recognized that its policy concerning the burdens a pipeline must satisfy to obtain a discount-type adjustment for negotiated rates have changed and evolved over time. While the Commission has consistently reiterated its intent that "customers electing the recourse rates will be no worse off as a result of the use of negotiated rates," <sup>76</sup> *Tennessee* stated that "the Commission's statements in individual cases concerning how to accomplish that goal have varied." <sup>77</sup> In addition, *Tennessee* <sup>78</sup>

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the *Enbridge*-approved language in their tariffs, the Commission, without explanation, accepted the revised WIC tariff language that has been used by pipelines for discount-type adjustments for negotiated rate contracts.

<sup>72</sup> *Id.* 8 (citing *Tennessee* 135 FERC ¶ 61,208 at P 196).

<sup>73</sup> *Id.* 9 (citing *Texas Eastern Transmission, LP*, 121 FERC ¶ 61,207 (2007) (*Texas Eastern*)).

<sup>74</sup> *Id.* (citing *Texas Eastern*, 121 FERC ¶ 61,207 at P 4).

<sup>75</sup> *See Tennessee*, 135 FERC ¶ 61,208 at P 199.

<sup>76</sup> *Alternative Rate Policy Statement*, 74 FERC at 61,242.

<sup>77</sup> *Tennessee*, 135 FERC ¶ 61,208 at P 198.

<sup>78</sup> *Id.* P 200 and n.183.

recognized that some parties in that proceeding interpreted the *NorAm* line of cases as establishing a nearly blanket prohibition on pipelines seeking discount adjustments for negotiated rates, subject only to an exception for negotiated rate transactions converted from discounted transactions, as permitted in *Northwest*.

47. In their rehearing request, Cities point to the Commission's orders in *Enbridge*, *El Paso*, and *Nornew* as being consistent with that interpretation of the *NorAm* line of cases,<sup>79</sup> and contend that *WIC II* therefore "appears to be nothing more than an anomaly that pipelines have recently latched onto."<sup>80</sup> The Commission recognizes that the three orders cited by Cities, together with the May 2006 *WIC I* order, do appear to set forth a policy of prohibiting discount adjustments for negotiated rate transactions, except for negotiated rate transactions converted from discounted transactions. However, Cities fail to recognize that, while the pipelines in *Enbridge* and *Nornew* did not seek rehearing of the orders in their cases and El Paso's request for rehearing was dismissed as moot after a settlement of its case, WIC did seek rehearing of the *WIC I* order. As described above, in *WIC II*, the Commission partially granted rehearing in order to clarify that it does not have a *per se* prohibition on discount-type adjustments with respect to negotiated rates. However, the pipeline must include in its tariff a protective mechanism that will ensure that its negotiated rate transactions will not cause any inappropriate cost shifting, including shifting the cost of below maximum rate negotiated rate transactions to recourse rate shippers, while the pipeline retains the profits from above maximum rate negotiated rate transactions. *WIC II* found that the pipeline's revised tariff language satisfied this policy, despite the fact it did not limit discount-type adjustments to negotiated rate transactions converted from discounted rates.

48. Cities also assert that the Commission's statement that, "any revenue shortfall due to a negotiated rate lower than the incremental recourse rate cannot be recovered from existing shippers" in *Texas Eastern* affirmed the precedent established in *Enbridge*.<sup>81</sup> However, in *Texas Eastern*, the pipeline had not proposed any tariff provision concerning when it could seek a discount-type adjustment for negotiated rate agreements, and therefore the Commission was not addressing any issue concerning what such tariff provisions are acceptable.<sup>82</sup> Instead, the Commission was reviewing a negotiated rate

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<sup>79</sup> Specifically, the Commission's holdings regarding discount adjustments in *Enbridge*, *El Paso*, and *Nornew* are included in the *NorAm* line of cases.

<sup>80</sup> Cities Rehearing Request at 8.

<sup>81</sup> Cities Rehearing Request at 9 (citing *Texas Eastern*, 121 FERC ¶ 61,207 at P 4).

<sup>82</sup> *Texas Eastern*, 121 FERC ¶ 61,207 at P 4.

agreement submitted by Texas Eastern, which included a cap on the shipper's fuel charges. The language quoted by Cities responded to a commenter's request that the Commission condition approval of the negotiated rate agreement on Texas Eastern not including in its system fuel rates any revenue shortfall attributable to the fuel charge cap. The Commission stated that the condition was not necessary, because of the Commission's policy established in the *NorAm* line of cases regarding no discount adjustments for negotiated rates.<sup>83</sup>

49. To the extent the language in *Texas Eastern* may be read as stating that *NorAm* established a blanket prohibition on discount adjustments for negotiated rates regardless of any provision in the pipeline's tariff allowing such adjustments subject to conditions protecting recourse rate shippers, that language was overly broad. As described above, the Commission stated in *NorAm*, 81 FERC ¶ 61,204 at 61,872, that there was no *per se* prohibition of discount adjustments for negotiated rates and such an adjustment might be permitted if the pipeline has a tariff provision protecting recourse rate shippers from inappropriate cost shifting. However, we note that the statement in *Texas Eastern* was accurate with respect to the specific negotiated fuel rates there at issue. As the Commission recently held in *Rockies Express Pipeline LLC*,<sup>84</sup> because Commission policy requires pipelines to be at risk for discounts given between rate cases, the Commission does not permit discount-type adjustments in fuel tracking mechanisms. The Commission also stated that a tariff provision like the one at issue here would not authorize a discount-type adjustment to the pipeline's recourse fuel rates based on negotiated fuel caps.

## **2. Burden of Proof for Discount Adjustment Policy**

50. As Cities recognize, the Commission may depart from prior precedent, if it provides a reasoned explanation for doing so. In *Tennessee*,<sup>2</sup> the Commission reexamined its policy concerning discount-type adjustments for negotiated rates, and the Commission provided a full explanation why, to the extent any prior Commission orders might be interpreted as establishing a nearly blanket prohibition on pipelines seeking discount adjustments for negotiated rates, subject only to an exception for negotiated rate transactions converted from discounted transactions, the Commission would no longer follow such precedent.<sup>85</sup> In this section, we address Cities' contentions that that explanation was inadequate.

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<sup>83</sup> *Id.*

<sup>84</sup> 135 FERC ¶ 61,206 at P 10 (2011).

<sup>85</sup> *Tennessee*, 135 FERC ¶ 61,208 at PP 200-208.

a. **Cities' Argument**

51. In *Tennessee*, the Commission found that the tariff language approved in *WIC II* and *Columbia Gulf* provides a reasonable framework for considering in a general section 4 rate case whether to permit a discount adjustment for a pipeline's negotiated rate transactions. The Commission concluded that framework "better serves the ends of just and reasonable rates and practices than does a nearly blanket prohibition on any discount adjustments for negotiated rate transactions,"<sup>86</sup> subject only to the exception permitted under the *Northwest* mechanism.

52. As described above, the Commission held that a nearly blanket prohibition on discount adjustments for negotiated rates is too extreme, because it fails to recognize that pipelines may use negotiated rates to obtain additional shippers who would not contract for service at the pipeline's recourse rates.<sup>87</sup> Such negotiated rate transactions benefit the maximum rate recourse rate shippers by permitting the pipeline's fixed costs to be spread over more units of services. The Commission also explained how requiring the pipeline to satisfy burden of proof applicable to affiliate discounts requires the pipeline to provide detailed evidence concerning the competitive circumstances which required it to offer a below maximum rate negotiated rate, including the competitive alternatives the negotiated rate shipper had.<sup>88</sup>

53. The Commission also explained in detail how the revised policy approved in *Tennessee* addresses the Commission's concerns about inappropriate cost shifting, including the concern that pipelines should not be granted discount adjustments for below-maximum rate negotiated rate agreements without taking into account projected revenues from above-maximum rate negotiated rate agreements.

54. Cities do not contest our finding that pipelines may use negotiated rates to obtain additional shippers who would not contract for service at recourse rates and that such negotiated rate transactions benefit recourse rate shippers. Moreover, Cities do not contest the heavy burden the pipeline will have in order demonstrate that competition required it to offer the below maximum rate negotiated rate. Instead, Cities focus on our explanation of how our revised policy addresses the fact that, unlike discounted rates, negotiated rates may exceed the maximum recourse rate. Cities state that the Commission explains that it will take the following approach to deal with this variance:

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<sup>86</sup> *Id.* P 208

<sup>87</sup> *Id.* P 201.

<sup>88</sup> *Id.* P 206.

[I]f a pipeline chooses not to include in its tariff a provision permitting a discount adjustment for negotiated rates, “there is no requirement for the pipeline to flow-through to recourse rate shippers any revenue the pipeline receives under a negotiated rate agreement in excess of recourse rate levels.” In other words, in a section 4 rate case, the pipeline’s rates would be designed based on the assumption that all its negotiated rates were at the maximum recourse rate, even if during the test period the pipeline’s negotiated rate revenues exceeded its maximum recourse rates. As the Commission explained, “Where there is no tariff provision permitting a discount adjustment, the risk of cost shifting does not exist; therefore, pipelines are entitled to keep the profits from negotiated rates above the maximum recourse rate.”

However, if the pipeline includes in its tariff a provision permitting discount adjustments for negotiated rates of the type approved in *WIC [II]* and *Columbia Gulf*, then a pipeline may obtain a discount adjustment for negotiated rate transactions, if it satisfies the burden of proving that the negotiated rates were required to meet competition and that the adjustment does not have an adverse impact on recourse rate shippers. As part of considering the effect of the adjustment on recourse rate shippers, parties may raise the issue “whether or not the pipeline should be allowed to keep negotiated revenues in excess of the recourse rate.” In other words, if during the test period in a section 4 rate case, the rates for some negotiated rate transactions were in excess of the maximum recourse rate, the volumes associated with those transactions may be adjusted upward to allocate costs to those transactions based on the actual revenues received. In this way, the pipeline would not be able to shift the costs of below maximum rate negotiated rate transactions to the recourse rate shippers, while keeping the profits from above maximum rate negotiated rate transactions for itself.<sup>89</sup>

55. Cities argue that the Commission erred in adopting this approach for Texas Gas because it is faulty in several respects. First, Cities aver that this approach improperly shifts the burden of proof on parties other than the pipeline. Cities contend that, because pipelines bear the burden of proof in section 4 NGA rate cases, other parties should not

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<sup>89</sup> Cities Rehearing Request at 11-12 (citing *Tennessee*, 135 FERC ¶ 61,208 at PP 203-204) (internal citations omitted)).

have to raise the issue of whether the pipeline can keep revenues from negotiated rates in excess of the recourse rate. Instead, Cities assert that, as part of proving that its proposed rates are just and reasonable, the pipeline should be required to affirmatively demonstrate whether or not it obtained any such excess revenues. Cities claim that, if a pipeline collects excess revenues from negotiated rates, then it should be required to adjust the volumes associated with those transactions upward to allocate costs to those transactions based on the actual revenues received. Cities argue that this is a logical quid pro quo for the pipeline's decision to include a negotiated-rate discount adjustment provision in its tariff, and there is no basis for shifting the burden to other parties.

56. Second, Cities contend that adopting the *Tennessee* standard for Texas Gas establishes a one-sided regime favoring the pipeline which cannot withstand scrutiny under the NGA. Cities argue that, while it is good that revenues from contracts in excess of maximum rates may offset the discount adjustment, the following concern arises: only pipelines whose aggregate revenues from negotiated rate agreements would result in an overall discount adjustment will actually seek a discount adjustment. Cities state that pipelines with revenues from negotiated rate agreements that, in the aggregate, exceed the revenues they would receive under maximum recourse rates will not seek any adjustment. Cities argue that, if a pipeline does not seek a discount adjustment for its negotiated agreements then, under a strict reading of the language in *Tennessee*, the Commission would presumably bar customers from demonstrating that recourse rates should be adjusted downward to account for the excess revenues from such agreements. Cities aver that this means customers would always be at risk for subsidizing the pipeline when it under collects in the aggregate, but customers would never see a net benefit from aggregate over collections.

57. Similarly, Cities maintain that leaving it to the discretion of the pipeline as to whether to include a negotiated rate discount adjustment provision in its tariff opens the door for abuse: the pipeline will either add or delete the provision depending on whether it will work to its advantage in its next rate case.

**b. Commission Decision**

58. Contrary to Cities' arguments on rehearing, the Commission's revised policy concerning discount adjustments for negotiated rate transactions does not shift the burden of proof in rate proceedings from the pipeline to the other parties. The tariff language approved in Tennessee and this case expressly places on the pipeline the burden to demonstrate that any discount-type adjustment "does not have an adverse impact on recourse rate shippers." In *Tennessee*, the Commission stated:

*As part of considering whether the pipeline has satisfied that burden, the parties should evaluate all of the pipeline's cost and revenue data, including revenue from all its negotiated rate transactions. The analysis should not focus solely on the particular negotiated rate transactions for which the*

pipeline has sought a discount adjustment. Parties should also consider whether the pipeline obtained above-maximum rate revenues from other negotiated rate transactions which offsets the below-maximum rate revenues from the negotiated rate transactions for which the pipeline seeks a discount adjustment. If so, there should be a corresponding reduction in any proposed discount adjustment.<sup>90</sup>

59. Therefore, contrary to Cities' contention, the Commission has not shifted to customers any burden to show that above-maximum rate revenues have been properly accounted for in any proposed discount-type adjustment for negotiated rates. Rather, the pipeline will have the burden to show that its proposed discount adjustment takes into account all such revenues and that it has included an appropriate corresponding reduction in its proposed discount adjustment.

60. Nor is the revised policy adopted in *Tennessee* a one-sided policy that will favor the pipeline, as suggested by Cities. Cities argue that pipelines with tariff provisions of the type approved in *Tennessee* will only seek discount adjustments if their aggregate revenues from negotiated rate agreements are below the maximum recourse rate and thus will support an overall discount adjustment to rate design volumes. Cities then assert that, if such a pipeline does not seek a discount adjustment, "the Commission would presumably bar customers from demonstrating (either in a section 4 rate case or in a section 5 complaint proceeding) that recourse rates should be adjusted downward to account for the excess revenues from such agreements."<sup>91</sup> This is not true. The Commission stated in *Tennessee* that, if a pipeline has tariff language permitting it to seek a discount-type adjustment for negotiated rate transactions, parties may raise this issue. Specifically, the Commission stated:

If the pipeline's overall negotiated rate revenues exceeded its maximum recourse rates, parties may, as stated in *WIC [II]*, raise the issue whether costs should be allocated to the negotiated rate transactions based on the full revenues received in those transactions during the test period.<sup>92</sup>

61. Finally, Cities contend that by giving pipelines the choice whether to implement a tariff provision permitting a discount adjustment for negotiated rates, the Commission is opening the door for abuse. Cities suggest that because, absent such a provision, there is

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<sup>90</sup> *Tennessee*, 135 FERC ¶ 61,208 at P 207 (emphasis provided).

<sup>91</sup> Cities Rehearing Request at 13.

<sup>92</sup> *Tennessee*, 135 FERC ¶ 61,208 at P 207.

no requirement for the pipeline to flow-through to recourse rate shippers any above maximum rate negotiated rate revenue, the pipeline will either add or delete the provision depending on whether it will work to its advantage in its next rate case. The Commission may consider allegations of such abuse in individual cases. For example, if a pipeline implements a tariff provision permitting discount adjustments for negotiated rate transactions and thereafter proposes to delete the provision, the Commission can consider whether the proposed deletion is just and reasonable and how any such deletion may affect the treatment of overall negotiated rate revenues in excess of the maximum recourse rate in the pipeline's next section 4 rate case.

62. For these reasons, the Commission concludes that Texas Gas' proposed tariff language provides a reasonable framework for considering in a general section 4 rate case whether to permit a discount adjustment for a pipeline's negotiated rate transactions. That tariff language accommodates the interests of all concerned, including the pipeline and its customers. At the hearing in the section 4 rate case, all parties will be free to present evidence and argue whether the pipeline has adequately protected the recourse rate customers. This should bring before the Commission all the facts about the relevant transactions for reasoned decision on whether the negotiated rate transactions benefitted the recourse rate shipper or whether a discount adjustment would cause unreasonable cost-shifting. Such an approach better serves the ends of just and reasonable rates and practices than does a nearly blanket prohibition on any discount adjustments for negotiated rate transactions.<sup>93</sup> Therefore, the Commission reaffirms the policy adopted in *WIC II* and *Columbia Gulf*.

### **3. Retroactive vs. Prospective Application of Policy**

#### **a. Cities' Argument**

63. Next, Cities contend that the Commission should prohibit Texas Gas from seeking a discount adjustment for negotiated rate agreements entered into before the effectiveness of the tariff provisions filed in this proceeding. Cities assert that the general theory supporting discount adjustments is that such an adjustment gives the pipeline an incentive to discount which, in turn, benefits the maximum-rate customers by spreading the pipeline's costs over more units of service.<sup>94</sup> Cities argue, accepting the validity of this statement for argument's sake, it is illogical to allow Texas Gas to seek discount adjustments for negotiated rate agreements entered into prior to the effective date of its

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<sup>93</sup> See *Southern*, 95 FERC at 62,379.

<sup>94</sup> Cities Rehearing Request at 14 (citing *Tennessee*, 135 FERC ¶ 61,208 at PP 188, 201).

tariff provision in this proceeding. Cities allege that the pipeline entered into these agreements under a rule requiring it – not captive customers – to bear the responsibility for any recoveries of costs. Therefore, Cities contend that customers should not be forced to bear a burden that Texas Gas previously demonstrated it was willing to bear. Cities state that such a result would be consistent with the result of another Texas Gas proceeding in which the Commission made a predetermination that the pipeline could not include pre-existing projects in a proposed fuel-savings sharing mechanism.<sup>95</sup>

64. Finally, Cities argue that Texas Gas contends that it relied on the ability to seek discount adjustments in entering into these pre-existing contracts.<sup>96</sup> However, Cities assert that the Commission should reject this claim as unsupported. Cities state that, prior to the effective date of these revisions, Texas Gas' tariff only permitted discount adjustments for negotiated rate that had been converted from discount agreements existing prior to September 2000, and that limitation had been in the tariff since 2000.

**b. Commission Decision**

65. The Commission finds that it is premature at this time to determine the extent to which Texas Gas may be permitted a discount adjustment in its next section 4 rate case for negotiated rate agreements entered into before the effectiveness of the tariff provisions approved in this proceeding. Texas Gas has not filed a section 4 rate case since it filed the instant tariff language. Therefore, it is unknown at this time what any future section 4 rate case filed by Texas Gas will contain. The Commission cannot prejudge this matter in the abstract, without knowing the particular facts concerning the specific negotiated rate transactions for which a discount adjustment might be sought.

66. During any general section 4 rate case proceeding, the pipeline will have the burden of proof, using the procedure outlined in its tariff, and must show that its agreement meets the conditions for discount adjustment, including that competition required it to offer a negotiated rate that is below the maximum recourse rate. The

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<sup>95</sup> *Id.* 14-15 (citing *Texas Gas Transmission, LLC*, 126 FERC ¶ 61,235, at P 32 (2009) (*Texas Gas Fuel Order*)).

<sup>96</sup> Cities state that, in support of its assertion, Texas Gas cited *Northwest Pipeline Corp*, 84 FERC ¶ 61,109 (1998), a decision in which FERC-approved tariff language similar to the limited provision added to the Texas Gas tariff in 2000. Cities contend that this argument defies logic that Texas Gas would rely on *Northwest* because (1) the case does not apply to the instant type of discount agreements; and (2) two years after the decision in *Northwest*, Texas Gas filed tariff language only permitting discount adjustments for converted negotiated rate agreements.

intervenors will have the ability to contest the pipeline's evidence at that time, including whether the absence of any tariff provision permitting a discount adjustment for negotiated rate transactions affected the pipeline's motivations or reasoning in deciding to offer the subject negotiated rate. This procedure comports with our previous rulings on discount adjustments because the Commission has consistently determined to examine the issues concerning discount adjustments on a case by case basis rate case, where all the facts related to the specific case are available in order to arrive at a reasoned decision.

The Commission orders:

Cities' request for rehearing of the Commission's July 13, 2011 order in the above-captioned matter is denied.

By the Commission.

( S E A L )

Nathaniel J. Davis, Sr.,  
Deputy Secretary.