

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Northern Natural Gas Company

Docket No. RP06-437-000

DECLARATORY ORDER AUTHORIZING MARKET-BASED RATES

(Issued November 16, 2006)

1. In this order, we grant Northern Natural Gas Company's (Northern Natural) petition for a declaratory order finding that under the facts as presented by Northern Natural, it would be authorized to charge market-based rates to the initial shippers that submitted winning bids and signed precedent agreements for Firm Deferred Delivery (FDD) service that results from a planned expansion (2008 FDD Expansion) of its aquifer field in Redfield, Iowa. We find that under the facts presented, Northern Natural meets the requirements established for market based rates under section 4(f) of the Natural Gas Act¹ (NGA) and the implementing regulations, sections 284.501, 284.502 and 284.505 of the Commission's regulations.²

I. Background

A. Northern Natural's Current System

2. Northern Natural operates an interstate natural gas pipeline that extends from the Permian Basin in Texas to the upper Midwest. Northern Natural has a total firm storage cycle capacity of approximately 65 Bcf and peak withdrawal capability of more than 1.7 Bcf/day. Northern Natural's storage services are provided through the operation of underground storage fields in Iowa, Kansas, and Minnesota. Rate Schedule FDD contains the specific terms and conditions of Northern Natural's firm storage service. Rate Schedule FDD service provided as a result of the 2008 FDD Expansion, although

¹ Energy Policy Act of 2005, Pub. L. No. 109-58, Section 312, 119 Stat. 594, 688 (2005) (to be codified at 15 U.S.C. § 717 c(f)(1)(A)).

² 18 C.F.R. §§ 284.501, 284.502, and 284.505 (2006). *See* Rate Regulation of Certain Natural Gas Storage Facilities, Order No. 678, 71 FR 36612 (June 27, 2006), FERC Stats. & Regs. [Regulations Preambles] ¶ 31,220 (June 19, 2006).

based on a physical expansion of the Redfield facility, will be subject to the existing terms and conditions of Northern Natural's FDD Rate Schedule and will be provided at any of the storage points available under the FDD Rate Schedule.

Northern Natural's Proposed 2008 FDD Expansion

3. Northern Natural proposes an expansion of its Redfield storage field which is a 122 Bcf underground aquifer natural gas storage facility. Service from the Redfield storage field is provided as part of Northern Natural's deferred delivery services under cost-based rates. Northern Natural states that as a result of expressed interest in additional storage, it analyzed additional areas of its Redfield storage field to determine the possibility of creating additional firm storage capacity on its system. The 2008 FDD Expansion initially was estimated to be approximately 10 Bcf in size with a peak withdrawal rate of 175 MMcf/day. Northern Natural states that it will file the necessary section 7(c) application in late March 2007, after all of the required field tests have been completed.

4. Northern Natural states that it determined that market-based rates were necessary for the 2008 FDD Expansion after conducting an open season to determine customer interest. In order to support the required investment for the expansion, the open season indicated a maximum and minimum price, both of which were in excess of the existing maximum FDD rate. Besides the positive customer response to the open season, Northern Natural cites other reasons to justify market-based rates. Northern Natural argues that the risk associated with the development of an aquifer storage facility warrants a higher rate of return than traditional pipeline investment. Thus, by using market-based rates, Northern Natural states that it would be able to offer prospective customers rate certainty while taking on itself the significant risk that accompanies operation of the facility. In addition, Northern Natural states that it would also be better able to protect existing Rate Schedule FDD customers from the potential risk associated with the project.

B. Notice and Interventions

5. Notice of Northern Natural's filing issued on July 19, 2006, with interventions and protests due as provided in section 154.210 of the Commission's regulations, 18 C.F.R. § 154.210 (2006). Pursuant to Rule 214, 18 C.F.R § 385.214 (2006), all timely motions to intervene and any motions to intervene out-of-time filed before the issuance date of this order are granted. Granting late intervention at this stage of the proceeding will not disrupt the proceeding or place additional burdens on existing parties. Xcel Energy Services, Inc. and Aquila, Inc. filed brief comments in support of the filing. Protests were filed by Constellation NewEnergy-Gas Division, LLC (Constellation) and Northern Municipal Distributors Group (NMDG) jointly with Midwest Region Gas Task Force

Association (Midwest Task Force). Northern Natural filed an answer to the protests on August 9, 2006.³

6. In their joint protest, NMDG and Midwest Task Force (collectively, Protesters) raise several issues. First, they assert that Northern Natural should not have filed the instant petition on July 17, 2006 because Order No. 678 was not effective until July 27, 2006. Protesters assert that because the outcome of the many requests for rehearing of Order No. 678 is unknown, this filing is premature. Second, Protesters argue that Northern Natural's petition fails to demonstrate how it plans to protect existing shippers from subsidizing the operating and other ongoing expenses associated with that portion of Redfield storage that is under market based rates. Lastly, Protesters assert that Northern Natural initially announced the open season prior to the issuance of the Notice of Proposed Rulemaking (NOPR) that led to the new regulations. Therefore, they question whether Northern acted reasonably in choosing among the options of utilizing the new regulations, relying on existing market power analyses, or traditional cost-based rates to determine how to design their proposed rates. Protesters question what standards Northern applied to make this rate design calculation.

7. Constellation, in its protest, shares the same view as NMDG and the Midwest Task Force. Namely, Constellation argues that, in light of the early, hypothetical stage of the expansion project's development and Northern Natural's right to decline to proceed with the project for reasons unrelated to the market based rate determination, the petition is premature. Constellation further states that the same lack of specificity that renders Northern Natural's filing premature also has prevented Northern Natural from presenting the requisite facts necessary for the Commission to make a determination that the market-based rates are in the public interest, and that market-based rates are necessary for the furtherance of the project.

8. In its answer, Northern Natural states that its filing is not premature because the FDD Expansion is well underway (and thus not in a hypothetical stage), and the whole purpose of the declaratory order is to provide commercial certainty to the parties involved, so that even more progress may be made. Northern Natural also states that both section 4(f) of the NGA and Order No. 678 are final and in effect, and so its filing is appropriate at this time. Northern Natural continues by saying that it provided more than enough details in its filing to support the petition requested, including how it meets each of the necessary criteria for market-based rates. Finally, Northern Natural responds to

³ Pursuant to Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2006), an answer may not be made to a protest unless otherwise ordered by the decisional authority. However, the Commission will waive Rule 213(a)(2) and accept Northern Natural's answer as it may aid in the disposition of the issues raised by the filing.

NMDG's and Midwest Task Force's protests by stating that its petition fully addresses how current Rate Schedule FDD customers will be protected and how it will not impose the incremental costs related to the 2008 FDD Expansion and its operation upon such existing customers.

II. Discussion

9. The Commission finds that Northern Natural meets the criteria necessary to negotiate market-based rates for the shippers that submitted winning bids in the 2006 Open Season and that signed precedent agreements, for the reasons set forth below.⁴

10. As a preliminary matter, some protesters contend Northern Natural's application was premature, because the Commission has not issued a final order on rehearing, the open season was conducted prior to the issuance of the final rule, and the declaratory order request is premature. The Commission does not find this application premature, as protesters contend. The Commission addressed the rehearing petitions to Order No. 678 in a contemporaneous order, thus a final order has issued, and therefore we find no reason to delay our consideration of Northern Natural's petition. Northern Natural's determination to conduct its open season prior to the issuance of the final rule does not bar Northern Natural's application so long as its open season conforms with the final rule, as we determine below. As we found in Order No. 678, a request for a declaratory order is an appropriate vehicle for obtaining consideration of market based rates.⁵ The details in Northern Natural's petition are specific enough to demonstrate that the expansion project is well beyond the hypothetical stage and that a declaratory order is an appropriate step at this juncture.

11. In Order No. 678, the Commission promulgated rules to implement new section 4(f) of the NGA, to permit underground natural gas storage service providers that are unable to show that they lack market power to negotiate market-based rates in circumstances where market-based rates are in the public interest and necessary to encourage the construction of the storage capacity in the area needing storage services, and where customers are adequately protected. More specifically, underground natural gas storage providers must meet the following criteria in order to negotiate market-based rates: (1) the capacity must relate to any "specific facility" requiring certification placed

⁴ Northern Natural proposed market-based rates only for the rates in the precedent agreements signed during the open season, and therefore, the use of market-based rates does not apply to sales of this storage capacity outside of these precedent agreements.

⁵ 18 C.F.R. § 284.502 (b)(1) (2006) provides that a request for a declaratory order is an appropriate method for obtaining a determination of market based rates. While requests for market-based rates may be filed with certificate applications, there is no requirement that the declaratory order approach not be used.

in service after the date of the Energy Policy Act of 2005, be it a new storage cavern or a facility which expands capacity at an existing cavern or reservoir;⁶ (2) the market-based rates must be in the public interest and necessary to encourage the construction of storage capacity in the area needing storage services;⁷ and (3) customers must be adequately protected.⁸ We will consider below the specific aspects of Northern Natural's compliance with the requirements for market-based rates.

A. The Facility Will Be Placed Into Service after August 8, 2005

12. In order to seek market based rates for storage capacity under section 284.505(a),⁹ the storage capacity must be related to a specific facility put into service after August 8, 2005. Northern Natural states that the ultimate design of the facilities necessary for this project will be completed after the receipt of the final reservoir analysis that determines the cycle capability of the field, including the number of wells and the base gas required to gain the deliverability needed. Northern Natural plans to build the facilities necessary to provide the firm service in 2008.¹⁰ The Commission finds that Northern Natural's petition has demonstrated that the 2008 FDD Expansion relates to specific facilities to be placed in service after August 8, 2005.

B. Market-Based Rates Are In The Public Interest And Necessary To Encourage The Construction Of The Storage Capacity In The Area Needing Storage Service

13. The Commission stated in Order No. 678 that in determining whether market-based rates are in the public interest, it would consider, among other things, the risk faced by the project sponsors, the extent to which additional capacity is needed in the area of the project, and the strength of the applicant's showing that the facilities would not be

⁶ Order No. 678, FERC Stats. & Regs. [Regulations Preambles] ¶ 31,220 at P 115.

⁷ *Id.* at P 125-132.

⁸ *Id.* at P 153-159.

⁹ 18 C.F.R. § 284.505(a) (2006).

¹⁰ Northern Natural states that it also plans to file a section 7(c) certificate application in September 2006 to increase the peak inventory capability of Redfield from 122 Bcf to 124 Bcf. If approved, Northern Natural would make available an incremental 2 Bcf of interruptible deferred delivery service under the IDD and PDD Rate Schedules. Once Northern Natural has received approval to charge market-based rates, Northern Natural states that it will, at the time it makes its section 7(c) filing, include specific facilities required to provide firm capacity from such 2 Bcf of capacity.

built but for market-based rate treatment.¹¹ Each applicant also must make a showing as to why market-based rates are necessary to encourage the construction of the storage capacity.¹² As discussed below, the Commission finds that the instant petition for market-based rates establishes that such rates are in the public interest and necessary to encourage the construction of the storage capacity in the area needing storage service.

14. Northern Natural states that while not all storage expansion projects will require market-based rates, it would not proceed with this project without market-based rates because of the risks of the project and the need for a potentially higher rate of return due to these risks. Northern Natural points out that gas treatment is needed to remove hydrogen sulfide, but the level of such expansion treatment costs, while likely to be significant, are unknown. It further argues that the amount of, and price of, its requirement for base gas is uncertain and that every additional 0.5 Bcf of base gas could potentially cost \$3.5m (or \$7.50 per dth) to \$5.3m (or \$10.70 per dth). Further it asserts that additional wells may be necessary to maintain deliverability and the cost of such wells is approximately \$2 million each to develop. In addition, Northern Natural asserts that there may be a need for additional treatment facilities to maintain pipeline quality specifications. Northern Natural maintains that these risks make it too difficult to project reasonable cost-based recourse rates and therefore, market based rates are necessary for the proposed project.

15. As stated previously, when considering whether market-based rates are in the public interest, the Commission considers whether additional storage is in fact needed in the area of the project, the risks of the project, and the strength of the applicant's showing that market-based rates are necessary for the project to go forward. The facts show that additional storage is needed in this area. The proposed expansion has been fully subscribed with long-term contracts, some of which extend to 20 years, and shippers submitted bids for more storage capacity (13 Bcf) than the amount of storage capacity included in the open season (10Bcf).¹³

16. Northern Natural states that it would not proceed with this project without market based rates and has shown that the project entails sufficient risk to justify such a decision. Northern Natural provided evidence of significant engineering uncertainties, including the potential need for treatment facilities, the possible need to construct additional wells,

¹¹ Order No. 678, FERC Stats. & Regs. [Regulations Preambles] ¶ 31,220, at P 128.

¹² *Id.* P 129.

¹³ Fifteen different customers submitted bids in the 2006 Open Season. Fourteen customers entered into contracts for terms of 20 years, while one customer bid for a term of only 10 years. Northern Natural Declaratory Order Petition at 32 and 35.

and the difficulty in determining the volume and price of base gas. For example, Northern Natural stated in its petition that the slightest change in base gas requirements after the field is in operation will have a significant cost impact, and that every additional 0.5 Bcf at currently-traded prices would equate to an incremental cost to Northern Natural of \$3.75 million. Northern Natural goes on to assert that at a price of \$10.70/Dth,¹⁴ the incremental cost would equal \$5.35 million.

17. As Northern Natural points out, this project does not fit the traditional cost based rate approach. Using traditional cost-based rates, Northern Natural's customers would be subject to potential rate increases through NGA section 4 filings if Northern Natural's cost projections were in error. In contrast, under Northern Natural's non-traditional approach the terms of its contracts provide its shippers with long-term (up to 20 year) fixed rate contracts and the concomitant rate security, while the risks of cost increases fall upon Northern Natural.

18. As the Commission stated in Order No. 678, to substantiate the finding that market based rates are in the public interest, we need to examine all aspects of the proposal. In this case, additional storage is clearly necessary in the area, Northern Natural identified significant investment risks with proceeding with the project, and the filing does not fit traditional cost-based rate applications since Northern Natural assumed all the risks of subsequent cost increases. In addition, Northern Natural asserts that the expansion project would not proceed absent market-based rates. Therefore, with adequate customer protections, market-based rates provides Northern Natural with the possibility of optimizing the efficient use of its existing infrastructure. In these circumstances, we find that market-based rates are in the public interest and are necessary to encourage the construction of the storage expansion project.

C. Customer Protection

19. In Order No. 678, the Commission required that storage applicants propose ways of protecting both the new customers for storage and existing customers. The Commission discussed various ways in which an applicant for market-based rates could provide adequate protection, such as: (1) a showing that the applicant conducted a fair and transparent open season, and complied with the nondiscriminatory access requirements of the Commission's regulations; (2) ensuring that existing customers are not subject to additional costs, risks or degradation of service resulting from new services provided under section 284.505;¹⁵ (3) providing service under an open access tariff stating the terms and conditions of the service offered; (4) submitting a proposal that

¹⁴ Northern Natural states in its petition that summer gas prices have traded as high as \$10.70/Dth.

¹⁵ 18 C.F.R. § 284.505 (2006).

adequately prevents withholding; and (5) establishing some form of a reserve price for use in an open season.¹⁶ The Commission finds that Northern Natural adequately protected both its expansion and existing customers.

20. In Order No. 678, the Commission recognized that a storage operator cannot exert market power as long as it does not withhold its capacity and offers a reasonable reserve price.¹⁷ Northern Natural held an open season in which it included all of the capacity that was estimated to be available in the storage project. Moreover, in the event that capacity exceeds the projected amount, Northern Natural commits to giving any additional capacity to the highest bidder that did not receive capacity under its open season auction.¹⁸ Northern Natural conducted a transparent auction where it awarded capacity to the shippers bidding the highest net present value, including rate and contract term. Rates resulting from such an auction reflect competitive prices, not the exercise of market power.¹⁹ Northern Natural provided further protection by establishing a maximum ceiling price of \$1.50 and a ceiling term of 20 years, such that any bids at or above the ceiling levels would be considered as if they were at the ceiling levels. In addition, Northern Natural met the other criteria established in Order No. 678 because it offered the proposed service pursuant to its General Terms and Conditions of service.

21. Northern Natural's proposal also adequately protects existing cost based rate customers. The rates of existing customers are unaffected by the instant proposal and, in accordance with section 284.504(a) of the Commission's regulations,²⁰ Northern Natural will separately account for all costs and revenues associated with facilities used to provide the market-based services. Maintaining separate records will help enable the Commission to ensure that existing customers will not subsidize the costs of the expansion.

22. Northern Natural, however, has not proposed any customer protections in the event that it becomes necessary for it to remarket any of the storage expansion capacity either after contract expiration or upon bankruptcy or another event leading to turn back

¹⁶ Rate Regulation of Certain Natural Gas Storage Facilities, 115 FERC ¶ 61,341, at P 154-67 (2006).

¹⁷ Order No. 678, FERC Stats. & Regs. [Regulations Preambles] ¶ 31,220, at P 163.

¹⁸ Northern Natural Declaratory Order Petition, at 35 n. 32.

¹⁹ *See Process Gas Consumers Group v. FERC*, 292 F.3d 831 (D.C. Cir. 2002); *American Gas Ass'n v. FERC*, 428 F.3d 255 (D.C. Cir. 2005).

²⁰ 18 C.F.R. § 284.504(a) (2006).

of the capacity.²¹ Therefore, our action today does not extend to permitting Northern Natural to charge market based rates for any subsequent sales of the expansion storage capacity.

The Commission orders:

Northern Natural's petition for a declaratory order is granted as discussed in the body of the order.

By the Commission. Commissioner Kelly dissenting with a separate statement attached.

(S E A L)

Magalie R. Salas,
Secretary.

²¹ Because Northern Natural has not proposed protections for future customers or replacement shippers, the maximum rate applicable to releases of storage capacity by expansion customers is the just and reasonable rate in their individual contracts with Northern Natural. *See, Kern River Gas Transmission Company*, 117 FERC ¶ 61,077 at P 335 (2006) (establishing maximum release rates based on the rate for each incremental rate schedule). When Northern Natural files its tariff to place these facilities in service, it must include these maximum release rates as part of its tariff.

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Northern Natural Gas Company

Docket No. RP06-437-000

(Issued November 16, 2006)

KELLY, Commissioner, *dissenting*:

I dissent from this order because I believe the applicant has failed to meet the requirements of Order No. 678 to: (1) prove that market-based rates are in the public interest (*i.e.* needed to permit the expansion) and (2) provide adequate customer protection.

When a utility is given the ability to charge market-based rates, we are really just removing regulatory controls on its ability to set its own prices and, instead, relying on market forces to provide price discipline. Accordingly, market-based rates are normally only in the public interest when adequate competition is present. When adequate competition is present, anyone trying to raise their price too high will risk having competitors take away their customers by charging less. In the absence of adequate competition, a party can raise its price without worrying about losing customers to competitors because there essentially are no competitors. Absent this competitive discipline on market-based rates, customers will be forced to pay more than they would in a competitive market and, accordingly, the public interest is not served.

Nevertheless, in the Energy Policy Act of 2005 Congress stated that, despite the lack of adequate competition, market-based rates might be in the public interest anyway if a storage project was needed and could not otherwise be built using either traditional or negotiated cost-based rates (and, importantly, if customers were protected by something other than the missing competition or cost-based rate regulation). It is our task under new NGA section 4(f) to determine whether these requirements have been met in each case.

Regarding the public interest requirement in Order No. 678, I believe the open season process here proves that market-based rates are not needed for this storage project and, accordingly, that market-based rates are not in the public interest in this case. First, we can expect that Northern designed the floor that it imposed on open season bidders to be somewhere above its current estimate of what it will cost to perform the expansion.¹ In other words, this floor can be expected to be no less than an initial cost-based rate for

¹ In fact, given Northern's extensive discussion of the risks of this expansion project, one can assume that the proposed floor is set well above Northern's current cost estimate, in order to provide some leeway in case of unforeseen expenses.

purposes of determining customer interest through precedent agreements. Bidders nevertheless requested more storage capacity than was offered and most of their bids were in fact above the floor. This indicates not only strong demand at a price level no less than the initial cost-based rate level would have been, but at even higher price levels as well. In the face of this, there does not appear to be strong evidence that customer objections would have prevented the use of a traditional cost-based rate.

This contrasts sharply with the situation in *Red Lake*,² where the applicant argued that there was inadequate customer interest at cost-based rates to justify construction of the project,³ and that it faced a currently “soft” market where it would be forced to discount below cost-based rates to make sales without the “possibility of making up this loss during tight markets.”⁴ Clearly, there is more than enough current customer interest in Northern’s proposed expansion and this abundant interest demonstrates a “tight” market rather than a “soft” one. A situation like that in *Red Lake* is better suited to application of new NGA section 4(f) than the situation here.⁵

The Commission’s alternative negotiated rate program could also have been used and might well have resulted in the same negotiated rates. However, the difference would have been that customers would be protected in their negotiations by the cost-based recourse rate, which was absent here.

It is interesting to note that, while Northern’s application indicates that market-based rates are necessary for this project, even if we denied such market-based rates, Northern has reserved the option through its draft precedent agreement to go forward with the project under cost-based rates (see P 2 of the draft precedent agreement attached to Northern’s filing). Indeed, given the robust customer interest at the proposed rate

² *Red Lake Gas Storage, L.P.*, 102 FERC ¶ 61,077, *reh’g denied*, 103 FERC ¶ 61,277. (*Red Lake*)

³ *Red Lake* argued on rehearing that its open season resulted in highly contingent precedent agreements covering only 61 percent of its proposed capacity. See 103 FERC ¶ 61,277 at P 30.

⁴ *Id.*

⁵ Indeed, in addressing the requirement for an applicant to show why market-based rates are necessary to encourage the construction of storage capacity, Order No. 678 specifically stated that “one way that the applicant could make such a showing is to present evidence that it offered its capacity at cost-based rates through an open season and was unable to obtain sufficient long-term commitments at those cost-based rates.” Order No. 678 at P 129. Accordingly, unlike Northern, it appears that *Red Lake* would have met this requirement.

levels, it seems unlikely that Northern would forego exercising this contractual option to move forward with the project under cost-based rates that would include a Commission-approved ROE commensurate with the risks of the aquifer storage expansion project. In summary, while the applicant supported the need for the expansion, it has not supported the need for market-based rates.

I also do not believe that the applicant supported its claim of adequate customer protection. First, Northern claims that expansion customers are protected because this proposal gives them rate certainty over a 20-year period by shifting the risk of cost increases to Northern. However, unlike the situation for customers who are bound by the terms of the precedent agreements they signed, there appear to be two contractual provisions that give Northern the ability to back out of the expansion if it wants to for economic reasons.

The first one is in P 4(b) of the draft precedent agreement and states that “[i]f the final costs determined by Northern require higher rates than set forth in the precedent agreements, Northern will notify customers that it will not execute the precedent agreements and will hold another open season.” The second, even broader “out” is in P 7(b) of the draft precedent agreement and states that “Northern shall have the right *at any time* to terminate this Precedent Agreement *and any resulting FDD Agreement* and to withdraw any requests or application for regulatory approvals if Northern determines, *in its sole discretion*, that the FDD Expansion, or portion thereof, has become uneconomical for Northern to pursue.”(emphasis added) Because Northern will not even present FDD Agreements to its customers until after its cost studies are complete and it has signed the precedent agreements, this appears to let Northern cancel the expansion even after it has committed to it by signing the precedent agreements that bind its customers. That does not seem to be consistent with the idea that Northern is accepting the risks of the project. Rather, the customers who signed precedent agreements are bound by them but Northern is never bound, even after it moves to the FDD Agreement stage. When one side can extract a much better deal for itself than the other side is able to get, that constitutes a text-book example of exercising market power and is not consistent with customer protection.

Moreover, Northern claims that its customers prefer this proposal because of the rate certainty it allegedly provides them. However, the customers who sought desperately needed capacity from the incumbent storage provider were forced to sign away their right to protest the proposal as part of the precedent agreement (see P 10 of the draft precedent agreement) so we don’t have unbiased feedback from the customers. Even Xcel’s very brief comments in support of the filing are prefaced by a statement that the precedent agreement they signed requires them to support the filing. At best we can say that customers desperately want storage from a monopoly provider but we can’t say that they support market-based rates for that provider just because they signed the precedent agreements. The monopolist forbid them from commenting honestly on the

issue as a condition of service they can't get without winning the monopolist's good favor.

Turning to the order's rationale for why customers are protected, I disagree that Northern's open season provided the needed protection. The order cites (at footnote 19) to certain court cases for the proposition that rates resulting from an auction *with the characteristics of the one that Northern held*, reflect competitive prices rather than the exercise of market power. However, while those cases involved auctions with some of the characteristics of the Northern open season, the deciding auction characteristic in those cases is not present here. Those cases reviewed the Commission's decision to eliminate a cap on *term*-length when the customers were protected by the existence of a cost-based maximum rate. The court's ultimate decision to affirm the Commission's contract term length findings specifically turned on the existence of Commission-regulated cost-based rates. Here, there is no cost based rate to protect customers and, while the proposal does contain term caps of 20 years, those term caps are long enough that, in the absence of a cost-based rate, they would still trigger the concerns that were raised by the court in an earlier phase of that proceeding.⁶ These court cases, thus, do not speak to the relevant issue of market-based rates in an auction and do not support the draft order's contention that Northern's auction process protected customers, either from a rate or term length perspective.

Further, P 20 of the draft includes the following statement: "In Order No. 678, the Commission recognized that a storage operator cannot exert market power as long as it does not withhold its capacity and offers a reasonable reserve price." Again, there was no reserve price, let alone a "reasonable" reserve price, in Northern's open season.

Further, as both FERC and the courts have recognized, monopoly pipelines can exert market power even without withholding capacity or raising price. The court's initial concerns in the *Process Gas I* case cited above involved the potential for the pipeline to exert market power by requiring customers to sign up for longer terms of service than they otherwise would in a truly competitive market. In fact, while the Commission found (and the court ultimately agreed) that this term-based concern was not relevant to new expansion customers *protected by cost-based rates*, with the court's approval the Commission retained a term cap for the expiring contracts of existing customers with a right of first refusal, finding that those customers should continue to be protected from this form of market power abuse.⁷

⁶ The court initially found that the Commission had not adequately supported its decision to approve a Tennessee Gas Pipeline proposal to increase its term cap to 20 years. See 336 U.S. App. D.C. 162; 177 F.3d 995 (*Process Gas I*).

⁷ See 352 U.S. App. D.C. 127; 292 F.3d 831 (*Process Gas II*).

In the absence of a cost-based rate cap, the term cap in Northern's auction does not address the term-based market power concerns discussed in *Process Gas I* and *Process Gas II*. Neither are the rate-based market power concerns that underlie the entire NGA, including new section 4(f), addressed by the proposed term cap or the proposed non-cost-based bid caps to which the customers are bound but to which the provider is never truly bound, as explained above. Therefore, the proposal does not meet the customer protection requirement of new section 4(f) or Order No. 678.

Having determined that this proposal fails to meet two key requirements of Order No. 678 and NGA section 4(f), I respectfully dissent from this order authorizing the proposal.

Suedeem G. Kelly