UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, Joseph T. Kelliher,
and Suedeen G. Kelly.

LSP-Cottage Grove, L.P. and LSP-Whitewater Limited Partnership	Docket Nos. RP03-604-002 RP03-604-003
v.	
Northern Natural Gas Company	
Northern Natural Gas Company	RP05-70-001 RP05-70-002

(Not Consolidated)

ORDER ON REHEARING AND CLARIFICATION AND ON COMPLIANCE FILING

(Issued April 20, 2005)

1. Northern Natural Gas Company (Northern Natural) asks for rehearing and clarification of the Commission order of December 30, 2004.[1] The Commission continues to find key provisions of the Northern Natural service agreements at issue in this proceeding to be unlawful and denies Northern Natural's requests for the reasons given below. This order benefits the public by resolving a dispute between a natural gas company and its customers and by enforcing and clarifying the Commission's policies and regulations concerning gas transmission contracting, competition, and discounting.

[1] *Order on Complaint, Rehearing, and Proposed Service Agreement Amendments*, 109 FERC ¶ 61,390 (2004) (December 30 Order).

Background

2. The background of this proceeding is given in detail in prior orders.[2] In brief, Northern Natural entered into service agreements with LSP-Cottage Grove, L.P and LSP-Whitewater Limited Partnership (Cottage Grove and Whitewater) for firm transportation service in Northern Natural's market area. These firm service agreements are known as the 1995 Letter Agreements. Northern Natural also executed with each shipper contracts for interruptible transportation service under its Rate Schedule TI in its Field Area at $0.05/MMBtu (the nickel rate). Subsequently, Cottage Grove and Whitewater filed a complaint alleging that Northern Natural was improperly charging them for interruptible transportation service under the 1995 Letter Agreements.

3. Paragraph E(3) of the 1995 Letter Agreements provides that Cottage Grove and Whitewater will pay the Nickel Rate for interruptible transportation on volumes received at their Market Area Delivery Points without using the interruptible Field Area transportation service that they have with Northern Natural. The payment would be made through an adjustment to the reservation charge for the shipper's firm service during the following year. Paragraph E(4) of the 1995 Letter Agreements provides that Cottage Grove and Whitewater will also pay the Nickel Rate for interruptible Field Area transportation for volumes that it transports in Northern Natural's Field Area using released firm capacity of a third party or alternate Field Area transportation without using the above interruptible service agreements.

4. In an order issued December 22, 2003, the Commission found that the 1995 Letter Agreements appeared to contain material deviations which would require that they be filed with the Commission and made available to the public.[3] It also found that some of the provisions that appeared to be material deviations, including those in paragraph E(3) under which Northern Natural sought to recover charges from Cottage Grove and Whitewater for interruptible transportation, and those in paragraph E(4) could be unlawful. It ordered Northern Natural to show cause why the specified provisions were not material deviations and were not unlawful.[4]

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[2] December 30 Order at P 5-18; *Order on Complaint and to Show Cause*, 105 FERC ¶ 61,326 at P 4-11 (2003).

[3] 105 FERC ¶ 61,326 (2003).

[4] Subsequently, on February 2, 2004, the Commission made the 1995 Letter Agreements available to the public when the parties voiced no objection. 106 FERC ¶ 61,097 (2004).

5. On April 19, 2004, and again on July 23, 2004, Northern Natural stated that the parties were attempting to settle the Complaint and intended to execute and file new service agreements. On November 15, 2004, in Docket No. RP05-70-000, Northern Natural filed amendments to the parties' transportation and storage service agreements which reflected their negotiated settlement (agreement amendments or 2004 Agreement amendments).

6. In the December 30 Order, among other things, the Commission found that the 1995 Letter Agreements contain material deviations from Northern Natural's *pro forma* service agreements. It also found that a number of the material deviations in the 1995 Letter Agreements are unlawful, in particular, paragraphs E(3) and E(4). The Commission found that paragraph E(3) was unlawful because it required Cottage Grove and Whitewater to pay for interruptible transportation service that they did not use;[5] because it constituted a revenue guarantee contrary to section 284.10 (c)(1) of the Commission's regulations;[6] and because it bundled services contrary to the Commission's policies and regulations.[7] The Commission also found that paragraph E(3) was unlawful because it was anti-competitive in that it discouraged the Complainants from buying gas supplies on other pipeline systems and using transportation on other pipeline systems. The Commission found as well that paragraph E(3) violated the Commission's policy that customers should pay only for the facilities that they actually use.[8] With regard to paragraph E(4), the Commission held that it was unlawful because it discourages capacity release, contrary to Order Nos. 636 and 637. That was because it required Cottage Grove and Whitewater to pay Northern Natural the Nickel rate, even if they took a capacity release.[9]

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[5] December 30 Order at P 29 and 30.

[6] *Id.* at P 30.

[7] *Id*. at P 30 *citing* Order No. 636 and *Transcontinental Gas Pipe Line Corp*., 87 FERC ¶ 61,087 at 61,398 (1999), *order on reh'g*, 94 FERC ¶ 61,362 at 62,321-22 (2001).

[8] *Id*. at P 32 *citing Panhandle Eastern Pipe Line Co*., 57 FERC ¶ 61,264 (1991), *reh'g denied in pertinent part*, 59 FERC ¶ 61,244 at 61,853 (1992); *see El Paso Natural Gas Co*., 61 FERC ¶ 61,173 at 61,633-34 (1992).

[9] *Id*. at P 33 *citing* 18 C.F.R. § 284.243 (1997), now 18 C.F.R. § 284.8 (b) (2004).

7. The Commission also rejected the agreement amendments for firm transportation service under Rate Schedules TF and TFX.[10] It found that a key provision to those amendments, described in more detail below, requires the shippers to pay for interruptible service in Northern Natural's Field Area regardless of whether the shippers use that service and that this provision is unlawful. The Commission found this provision was similar to paragraphs E(3) and E(4) in the 1995 Letter Agreements that it found to be unlawful. The Commission also rejected Northern Natural's proposed agreement amendments for TI service, since those amendments were integrally related to the rejected firm service amendments. Since the Commission rejected the proposed agreement amendments, it found the 1995 Letter Agreements survive and control the relations between the parties, to the extent not found unlawful.

8. The Commission conditionally accepted the agreement amendments for storage service under Rate Schedule FDD. It required Northern Natural (1) to file the underlying storage agreements so that the Commission can review them and (2) either to remove provisions permitting Cottage Grove and Whitewater to convert their storage service to new or alternative storage service or to file a tariff provision offering this option on a non-discriminatory basis to all customers.

9. The Commission prohibited Northern Natural from billing or collecting any amounts from Cottage Grove and Whitewater pursuant to the unlawful provisions in the 1995 Letter Agreements. The Commission required Northern Natural to revise its 1995 Letter Agreements consistent with the rulings in the December 30 Order and to file the revised provisions within 30 days. On January 31, 2005, Northern Natural made a filing to comply with the Commission's December 30 Order in Docket Nos. RP03-604-003 and RP05-70-002.

Rehearing Requests

A. 2004 Agreement Amendments

10. In its November 15, 2004 Filing, Northern Natural included non-conforming agreement amendments for TFX firm transportation service with Whitewater and TF firm transportation service with Cottage Grove. Section 2(a) of Northern Natural's TFX agreement amendments with Whitewater contained the following provision:

[10] Rate Schedules TF and TFX are for firm transportation service. Rate Schedule TI is for interruptible transportation service.

> Effective January 1, 2004, Shipper shall pay an annual average base reservation fee equal to $7.2181/Dth/month for Market Area MDQ ("Base Fee"). Effective January 1, 2005, and on January 1 of each year hereafter, an additional amount shall be added to the Base Fee based on the following formula ("Nickel Rate Formula"): (1) An amount equal to $0.0517 times all volumes delivered to POI No. 62883 in the previous year [Whitewater's Market Area Delivery Point] less (2) actual dollars paid to Northern for Field Area transportation pursuant to Shipper's interruptible service agreements with Northern [CR #s 24200 and 24201] during the previous year. The net of (1) and (2) will then be divided by the MDQ and shall be added to the Base Fee. Subject to approval of Shipper, Northern shall have the right to allocate the Base Fee, as adjusted by the Nickel Rate Formula, between winter and summer months and excess receipt point rates (as set out in Northern's FERC Gas Tariff) to achieve the annual average Base Fee, as adjusted by the Nickel Rate Formula; provided that at no time may Northern attempt to collect more than the maximum TFX rate as set out in its FERC Gas Tariff.

Northern Natural included a similar provision as section 2(a) of its Rate Schedule TF agreement amendments with Cottage Grove, only modifying the rates and delivery point.

11. The Commission found that the section 2(a) provisions were material deviations from Northern Natural's *pro forma* service agreement.[11] It held that the section 2(a) provisions would have required Cottage Grove and Whitewater to pay the nickel rate for interruptible service in the Field Area whether or not they actually used that service, just as paragraphs E(3) and E(4) of the 1995 Letter Agreements which the Commission found to be unlawful for this reason, as described above.[12] The Commission held that the requirement that the Complainants pay for interruptible Field area service they do not use improperly requires those customers to pay a reservation charge and/or minimum bill for interruptible service, improperly bundles market area firm transportation service and interruptible Field Area service, and has the anti-competitive effect of discouraging the use of capacity released by other shippers in competition with Northern Natural's sale of interruptible service.

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[11] December 30 Order at P73.

[12] *Id.* at P 71.

12. Northern Natural does not request rehearing with respect to the Commission's determinations in the December 30 Order concerning the 1995 Letter Agreements. Therefore, those determinations concerning the unlawfulness of the paragraph E(3) rate provisions for interruptible transportation in the 1995 Letter Agreements are final.

13. Northern Natural does request rehearing of the Commission's rulings on section 2(a) of the 2004 Agreement amendments for TF and TFX firm transportation service. Northern Natural asserts that the section 2(a) rate provisions in the agreement amendments are not the same as the provisions found to be unlawful in the 1995 Letter Agreements because they do not require Cottage Grove and Whitewater to pay for interruptible service that they do not use. Northern Natural also asserts that the section 2(a) rate provisions provide for permissible discounts for firm transportation and are not otherwise unlawful. As discussed below, the Commission finds that the section 2(a) rate provisions in the TF and TFX agreement amendments require the shippers to pay for interruptible service that they do not use and that they are anti-competitive and are thus unlawful. The Commission also finds they do not constitute permissible discounts. Accordingly, the Commission denies rehearing.

1. Is the section 2(a) rate a permissible adjustment to the firm reservation rate?

14. Northern Natural asserts it required a certain level of revenue to support building the facilities to serve Cottage Grove and Whitewater and that otherwise, other customers will be charged for these facilities. It states it could have used any of the following options to obtain the revenue for the Cottage Grove and Whitewater facilities: (1) a contribution in aid of construction; (2) a reservation charge substantial enough to provide the necessary reimbursement, disregarding interruptible revenue; or (3) a reservation charge that is adjusted to reflect interruptible transportation charges paid by the shipper. Northern Natural states it did not choose the third option in an effort to hinder competition or to require Cottage Grove and Whitewater to pay for service that they did not receive but rather that Cottage Grove and Whitewater chose the third option as it was most advantageous to them.

15. Northern Natural argues that the section 2(a) rate is a rate formula that adjusts the reservation charge for firm service. It asserts the rate formula "uses the level of interruptible service utilized by LSP as one factor in calculating the level of the

discounted reservation rate."[13] It asserts the section 2(a) rate provides that an additional amount shall be added to the Base Fee or reservation rate for firm transmission service based on a formula equal to $0.0517 (the Nickel Rate) times all volumes delivered to the Market Area delivery point in the previous year less actual dollars paid for Field Area interruptible transportation during the previous year. Northern Natural asserts the Nickel Rate and the actual volumes are used to adjust the reservation rate for firm service within the maximum and minimum firm reservation rates, not to make an additional charge for interruptible service

16. Northern Natural asserts the shippers do not pay the section 2(a) rate for interruptible service in Northern Natural's Field Area whether or not they use that service. It states the rate formula applies to all volumes actually delivered to the designated Market Area delivery point and only to volumes delivered to the Market Area delivery point. It states that if the shippers flow zero interruptible volumes from the Field Area, the interruptible charges for the Field Area will be zero, so that they do not pay for interruptible service in the Field Area regardless of whether they use that service. In other words, Northern Natural asserts the interruptible charges are only for volumes that flow in the Field Area.

17. Northern Natural asserts the Commission incorrectly relied on its view of the 1995 Letter Agreements when it evaluated the section 2(a) rates in the agreement amendments. It states that the rates in the 1995 Letter Agreements are different from the rates in the agreement amendments. Northern Natural asserts that Paragraph E(3) of the 1995 Letter Agreements used the volume of gas received in the Market Area during the previous year without utilizing Field Area interruptible transportation to adjust the firm reservation rate. Northern Natural states that, in contrast, the section 2(a) rate makes no reference to unused interruptible transportation. Instead, it asserts, the section 2(a) rate is a "reservation rate formula that adjusts the reservation rate based on all volumes delivered and gives the shipper credit for revenue generated from interruptible service."[14] Northern Natural also argues that the Nickel Rate is a reservation rate that is permissible under section 284.7(e) of the Commission's regulations.[15]

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[13] Northern Natural Request for Rehearing at p. 14. Northern Natural also states "revenue generated by interruptible throughput is one part of the formula for determining the level of the discounted reservation rate for firm throughput service." *Id*. at 18.

[14] Northern Natural Request for Rehearing at p. 8.

[15] 18 C.F.R. § 284.7(e) (2004).

18. Northern Natural asserts that its section 2(a) rate formula is not anti-competitive and does not result in bundling of services because it applies only to the actual volumes delivered and equally to firm volumes or interruptible volumes. Northern Natural states the shippers are free to flow firm volumes or interruptible volumes. Northern Natural asserts the section 2(a) rates are not anti-competitive toward either firm or interruptible service because they treat all volumes alike.

19. Northern Natural states the section 2(a) rate is not a minimum bill for interruptible service "because all fixed revenue is collected in the form of a permissible firm reservation charge."[16] Northern Natural asserts a minimum bill charge is defined as a "clause in a rate schedule which provides that the charge for a prescribed period shall not be less than a specified amount."[17] Northern Natural asserts that since the section 2(a) rate applies only to actual volumes delivered, there is no minimum bill.

20. Northern Natural states that where there are different interpretations, contracts should be construed to be valid and enforceable if one of the interpretations would make it effective. Northern Natural also argues that the Commission has violated the principles of contract construction by looking to the "functional effect" of the rate and not relying on the terms of the contract, which it asserts are plain and unambiguous, to determine the meaning of the rate provisions. Northern Natural asserts the Commission has failed to rely on an interpretation that would support the contract and on the plain meaning of the contract and thus that the Commission's rejection of the agreement amendments is arbitrary, capricious, and not reasoned decisionmaking.

21. The Commission denies rehearing on the unlawfulness of the section 2(a) rates. The Commission finds it is not possible to interpret the section 2(a) rates in a way that makes them permissible. The section 2(a) Nickel Rate formula reads as follows: "An additional amount shall be added to the Base Fee based on the following formula ("Nickel Rate Formula"): (1) An amount equal to $0.0517 times all volumes delivered to POI No. 62883 in the previous year [Whitewater's Market Area Delivery Point] less (2) actual dollars paid to Northern for Field Area transportation pursuant to Shipper's interruptible service agreements with Northern [CR #s 24200 and 24201] during the previous year. The net of (1) and (2) will then be divided by the MDQ and shall be added to the Base Fee."

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[16] Northern Natural Request for Rehearing at p. 5.

[17] Northern Natural Request for Rehearing at p. 5 *quoting Regulation of the Gas Industry*, American Gas Association, ed., Vol. 3, p. GL-100 (1991).

22. As we discussed in the December 30 Order, these provisions have the identical effect of requiring Whitewater and Cottage Grove to pay the nickel rate for interruptible service in the Field Area whether or not they actually use that service, as paragraphs E(3) and (4) of its 1995 Letter Agreements. Paragraphs E(3) and (4) required Whitewater and Cottage Grove to pay $0.05 per Dth for interruptible service they actually received in the Field Area. Those paragraphs then provided for the firm reservation charge paid by Whitewater and Cottage Grove in the following year to be increased by $0.05 multiplied by the volumes they received in the market area in the preceding year without using Field Area interruptible service, thereby in essence requiring the two customers to pay the $0.05 nickel rate for interruptible service in the Field Area whether or not they used the service.

23. The amended agreements take a somewhat different route to arrive at the same result. During the year service is received, Cottage Grove and Whitewater pay only the minimum rate for interruptible service actually received in the Field Area, or $0.0040\Dth for each 100 miles of service. Then the firm reservation charges they pay in the following year are increased by the adjusted $0.0517 nickel rate multiplied by the total volumes they received at their market area delivery point during the preceding year, with a credit for the minimum rate paid for interruptible service actually received in the Field Area. The end result is that Cottage Grove and Whitewater pay $0.0517 for the interruptible service they actually receive in the Field Area. They also must pay $0.0517 for volumes received in the market area without using interruptible service in the Field area. In other words, under the amended agreements, Cottage Grove and Whitewater must pay the adjusted nickel rate for interruptible service in the Field Area, whether or not they use that service.

24. The section 2(a) rates in the 2004 Agreement amendments thus require Cottage Grove and Whitewater to pay the exact same amounts for their service as if paragraphs E(3) and E(4) of the 1995 Letter Agreements that the Commission found to be unlawful remained in effect (aside from the increase in the nickel rate from $0.05 to $0.0517). All that is changed is the timing of the payments. Under the 1995 agreements, Cottage Grove and Whitewater pay the full nickel rate for interruptible service actually used in the Field Area during the year the service is used. They then pay the nickel rate for the interruptible service not used through an adjustment to the firm reservation charge in the following year. Under the 2004 amendments, during the year service is received, Cottage Grove and Whitewater only pay the minimum tariff rate for interruptible service actually received in the Field Area. Then, in the following year, through the adjustment to the firm reservation rate, they pay (1) the remaining amount for the interruptible service actually received in the Field Area necessary so that the full nickel rate is paid for that service and (2) the entire nickel rate for the interruptible service not used. Under both

approaches, the bottom line is the same: the two shippers pay the nickel rate whether or not they use interruptible service in the Field Area.

25. Northern Natural does not dispute that Cottage Grove and Whitewater's payments under the amended agreements will be essentially the same as under the 1995 Letter Agreements. However, it contends that Cottage Grove and Whitewater's payments under the agreement amendments must be treated as payments for firm Market Area service, and therefore the agreement amendments cannot be considered to have the unlawful effect of requiring Cottage Grove and Whitewater to pay for interruptible Field Area service, regardless of whether they use that service. Northern Natural emphasizes that the additional payment in section 2(a) of the 2004 amendments is structured as an adjustment to the reservation rate for firm service. It argues it is permissible to use the actual volumes delivered at the designated Market Area delivery point to adjust the reservation rate for firm transmission service in the Market Area. Northern Natural also argues that the Nickel Rate is a reservation rate that is permissible under section 284.7(e) of the Commission's regulations.[18]

26. We recognize that there is reason to consider the Nickel Rate provided for in the agreement amendments as a charge for firm Market Area service, since it is based on the amount of deliveries at the shipper's Market Area delivery point. However, regardless of whether the Nickel Rate was intended as a reservation charge for firm Market Area service or a usage charge for interruptible Field Area service, we find that the Nickel Rate is unlawful. A reservation charge is a payment to reserve the firm right to use a certain amount of capacity. As such, it varies with the amount of capacity reserved, i.e. the level of contract demand. The higher a shipper's contract demand, the higher the reservation charge it will pay. The lower the contract demand, the lower the reservation charge. A usage charge, by contrast, is a charge for the actual use of capacity. As such, the overall usage charge payment a shipper makes varies with the amount of the shipper's throughput. The higher the shipper's throughput, the higher the overall usage charge payment it will make. The lower the shipper's throughput, the lower the overall usage charge payment it will make.

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[18] 18 C.F.R. § 284.7(e) (2004). Section 284.7(e) provides in pertinent part: "Where the customer purchases firm service, a pipeline may impose a reservation fee or charge . . . . A reservation fee or charge may not recover any variable costs or fixed costs not attributable to the firm transportation service. Except as provided in this paragraph, the pipeline may not include in a rate for any transportation provided under subpart B,C or G of this part any minimum bill or minimum take provision, or any other provision that has the effect of guaranteeing revenue."

27. The Nickel Rate is clearly a usage charge, since the overall amount paid varies by the amount of deliveries made at the shipper's delivery point. It is not a reservation charge, since the overall amount Cottage Grove and Whitewater pay pursuant to the Nickel Rate does not vary based on their contract demands for firm service. Contract demand only enters into the Nickel Rate formula as part of a special billing mechanism for a payment that has already been determined by multiplying Cottage Grove and Whitewater's annual usage by the Nickel Rate. Dividing the amount of that payment by contract demand and then billing the resulting per-unit charge during the course of the following year does not alter the fact that the overall amount of the payment has been determined based on Cottage Grove and Whitewater's usage of Northern Natural's system.

28. Since the Nickel Rate must be considered a usage charge and not a reservation charge, it is unlawful whether it constitutes a charge for Market Area firm service, as claimed by Northern, or a charge for Field Area interruptible service, as we held in the last order. Viewed as a firm usage charge, the Nickel Rate violates Northern's tariff because it requires Cottage Grove and Whitewater to pay a usage charge that exceeds the maximum firm usage charge set forth in Northern's tariff for either TFX or TF Market Area service.[19] Paragraph 2.b of the amendment to the TF Throughput Service Agreement for Cottage Grove, contract No. 24042, requires Cottage Grove to pay a commodity rate equal to $0.0218/Dth, as well as the $0.0517/Dth nickel rate, for a total usage charge of $0.0735/Dth. This is in excess of the $0.0467 maximum TF usage charge for the Market Area. Paragraph 2.b of the amendment to the TFX service agreement for Whitewater requires Whitewater to pay a commodity rate of $0.0223/Dth, as well as the nickel rate, for a total usage charge of $0.0740/Dth. This is in excess of the $0.0467/Dth maximum usage charge for TFX service. Therefore, the Nickel Rate would violate the maximum usage rate for the relevant firm services. While Northern could agree to a volumetric rate in excess of the recourse firm usage rate in a negotiated rate agreement, which need not follow Northern's recourse rate design, it cannot do that in a maximum or discounted recourse rate filing as here.

29. Given that the charge is illegal as a firm usage charge and given Northern's own description of the purpose of the charge, there are also reasons to view the charge as being for the Field Area interruptible service. Northern itself states that the purpose of the charge was to guarantee a certain level of revenue from the overall service, firm market area and interruptible field area service. Thus, the charge does appear to be at

[19] Rate Schedule TF, 70 Revised Sheet No. 50; Rate Schedules TFX and LFT, 71 Revised Sheet No. 51, Northern Natural Gas Company, FERC Gas Tariff, Fifth Revised Volume No. 1.

least in part for the Field Area interruptible service. Viewed as a charge for interruptible service, the charge is unlawful for all the reasons given in the last order, including that it charges for some interruptible Field Area usage that hasn't actually occurred. In fact Northern Natural in effect concedes that if the charge is viewed as a charge for TI service it is unlawful. Guaranteeing revenue from interruptible transmission service is contrary to the Part 284 regulations.

30. The Commission affirms its determinations in the December 30 Order that the Nickel Rate in the agreement amendments is unlawful.

2. Is the section 2(a) rate a discount permissible under Northern Natural's Tariff or as a material deviation?

31. Northern Natural asserts that the section 2(a) rates are a permissible form of discount under section 54(B)(8) of its Tariff. That section states that Northern Natural may provide a specific discounted rate

> based on published index prices for specific receipt or delivery points or other agreed-upon pricing reference points for price determination. Such discounted rate may be based on the published index price point differential or arrived at by formula. Any service agreement containing such a discount will identify what rate component (i.e. reservation charge or usage charge or both) is discounted and any formula will produce a reservation rate per unit of contract demand.

Northern Natural asserts section 54(B)(8) permits discounts arrived at by formula and that the only requirements are that the discount must identify which rate component, such as the reservation charge, is being discounted and any formula must produce a reservation rate per unit of contract demand. Northern Natural states the section 2(a) rates are discounted reservation rates for firm service arrived at by formula and that they result in a reservation rate per unit. Northern Natural asks that if the section 2(a) rate is not permissible under section 54(B)(8) that the Commission accept it as a permissible material deviation.[20]

32. The Commission does not agree that the section 2(a) rates are a permissible discount under section 54(B)(8) of Northern Natural's tariff.[21] In a prior order dealing

[20] *Citing Northern Natural Gas Co. v. FERC*, 335 F.3d 1089 (D.C. Cir. 2003).

[21] Eighth Revised Sheet No. 303, Northern Natural Gas Company, FERC Gas Tariff, Fifth Revised Volume No. 1.

with this discount, the Commission required that the formula not alter the rate design on Northern Natural.[22] That is, the discounted rate for firm service must include a reservation charge component that falls within the maximum and minimum reservation rate in the tariff and usage charge component that falls within the maximum and minimum usage rate in the tariff. To ensure that rate design remained the same when Northern Natural gave a discount under section 54(B)(8), the Commission required Northern Natural to identify what rate component, reservation or usage or both, is discounted. The Commission also required Northern Natural to provide that the formula produce a rate per unit of contract demand when Northern Natural discounts the firm reservation charge.[23] Northern Natural's tariff includes these requirements.[24]

33. The section 2(a) rates do not meet the Commission's requirements that the same rate design be maintained when a discount is given under section 54(B)(8). As discussed above, the Nickel Rate does not qualify as a reservation charge, but rather is a usage charge. Treated as a usage charge for firm service, as Northern Natural seeks, the Nickel Rate causes Cottage Grove and Whitewater to pay a higher overall usage rate for firm service than permitted by the tariff. As such, the Nickel Rate improperly shifts costs from the reservation charge to the usage charge in a manner contrary to the design of Northern Natural's recourse rates. These alterations in rate design are contrary to the Commission's requirements and section 54(B)(8).

34. Moreover, as the Commission has previously stated, section 54(B)(8) permits Northern Natural to negotiate discounted rates that fluctuate based on published index prices for specific receipt or delivery points or other agreed-upon pricing reference points for price determination.[25] Here, section 2(a) does not adjust the discounted rate for changes in such published index prices, but rather for changes in the amount of revenue

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[22] *Northern Natural Gas Company*, 105 FERC ¶ 61,299 at P 8, 14, 20 and n.21 (2003).

[23] *Id.* at P 20 and n.21.

[24] Northern Natural's tariff provides in section 54(B)(8) that "[a]ny service agreement containing such a discount [based on published index prices] will identify what rate component (i.e. reservation charge or usage charge or both) is discounted and any formula will produce a reservation rate per unit of contract demand." Eighth Revised Sheet No. 303, Northern Natural Gas Company, FERC Gas Tariff, Fifth Revised Volume No. 1.

[25] December 30 Order at P 50.

received from interruptible transportation. The section 2(a) rates are not permitted under this or the other discounting provisions of Northern Natural's tariff,[26] as discussed further below, and are thus a material deviation from Northern Natural's *pro forma* service agreement. Further, the section 2(a) rates cannot be accepted as a material deviation, because, as explained above, they are unlawful.

3. Is the section 2(a) rate the same as a discount permitted in the 1995 Letter Agreements?

35. Northern Natural asserts the section 2(a) rates are the same as the Paragraph E(2) rates the Commission approved in the 1995 Letter Agreement for Cottage Grove. The Paragraph E(2) rates for Cottage Grove increase the TF reservation rate to make up for lost revenues if Northern Natural's maximum firm storage (FDD) rates decrease.[27] Northern Natural cites the Commission as saying the provision "simply provides for the adjustment of the rates paid by Cottage Grove, without affecting the quality of either Cottage Grove's service or the service provided any other shipper. Nor does it require Cottage Grove to pay for a service that it does not receive, and thus it does not raise the anti-competitive concerns raised by paragraphs E(3) and (4) . . . ."[28] Northern Natural asserts the section 2(a) rate has the identical effect of simply adjusting the reservation rate for one service by revenues received for another service.

36. The Commission does not agree that the section 2(a) rate is the same as the Paragraph E(2) rate for Cottage Grove. Paragraph E(2) simply provides for Cottage Grove's reservation rate for TF firm transportation service to increase to make up for a reduction in the maximum reservation rate for firm storage service. Any increase in the TF reservation rate pursuant to this provision would not be a function of Cottage Grove's *usage* of any service. Unlike the situation with the Nickel Rate, the overall increase in the TF reservation rate would not be determined by multiplying some per unit rate by actual deliveries to Cottage Grove. Rather, the increase would be determined based upon the decrease in the reservation rate Cottage Grove is paying per unit of contract demand for the firm storage service. Thus, the E(2) rate adjustment provision is consistent with

[26] Section 54(B)(1)-(7), Eighth Revised Sheet No. 303, Northern Natural Gas Company, FERC Gas Tariff, Fifth Revised Volume No. 1.

[27] December 30 Order at P 49.

[28] *Id*.

the design of Northern Natural's recourse rates for both TF transportation service and storage service and does not result in any rate component for either service exceeding the maximum recourse rate for that rate component

37. Moreover, since both services at issue are firm services, there is no issue as to whether the E(2) provision unlawfully guarantees Northern Natural revenue recovery. Northern Natural can have a charge that guaranteed revenue in its reservation rate for firm transportation service, as long as the reservation rate remained below the maximum. In addition, the collection of revenues in the firm transportation rate that were originally expected to be collected in the firm storage rate would not require Complainants to pay for firm transportation that they were not using. The amount of firm transportation service was already fixed by contract.

B. What are the relations between the parties?

38. Northern Natural states the Commission was inconsistent in finding the rate provisions of both the 1995 Letter Agreements and the 2004 Agreement amendments to be unlawful but rejecting the agreement amendments in their entirety and the 1995 Letter Agreements only in part. Northern Natural asserts the Commission should find both the 1995 Letter Agreements and the 2004 Agreement amendments to be null and void in their entirety. Northern Natural asserts that permitting the 1995 Letter Agreements to survive in part gives the shippers the benefit of their bargain without their having to pay for it and is thus arbitrary, capricious, and not reasoned decisionmaking.

39. Northern Natural asserts that, in any case, the 1995 Letter Agreements are now unenforceable. Northern Natural contends that if the performance of an essential part of an agreed exchange is unenforceable, which, here, it states is the payment of revenues as agreed by the parties, the contract wholly fails or is null and void.[29] Since in its view the 1995 Letter Agreements are null and void, Northern Natural requests rehearing of the December 30 Order's requirement to refile the 1995 Letter Agreements.

40. If the Commission denies rehearing and continues to hold that the rate provisions of the 2004 Agreement amendments and the 1995 Letter Agreements are unlawful, Northern Natural requests that the Commission clarify that it did not intend to nullify the

[29] *Citing Restatement (Second) of Contracts* § 184, comment a; *Central States Health & Life Company of Omaha v. Miracle Hills Limited Partnership*, 235 Neb. 592, 456 N.W. 2d 474 (1990). Northern Natural also cites 174 Am. Jur. 2d Contracts § 329, but this authority discusses ambiguity rather than enforceability of a contract once provisions have been found unlawful.

renegotiation provisions in section 6 of the TF agreement amendment and section 7 of the TFX agreement amendment and that the parties may conduct further negotiations pursuant to these provisions to reach new service agreements or amendments. Northern Natural asserts the Commission suggested this result when it stated that Northern Natural may decide to resubmit the TFX and TF agreement amendments with acceptable rate provisions[30] and found the renegotiation provision reasonable.[31] In the alternative, Northern Natural requests rehearing of this issue.

41. Cottage Grove and Whitewater filed an answer to Northern Natural's request for clarification. They state that Northern Natural's assertions are incorrect. They assert the Commission rejected six of the 2004 Agreement amendments and Northern Natural withdrew the other two so that there is no longer an obligation to negotiate new service agreements. They assert there was no bargain struck between the parties concerning certain facilities. They assert that paragraphs E(3) and (4) of the 1995 Letter Agreements, as well as section 2(a) of the 2004 Agreement amendments, were simply rate provisions and were not tied to the recovery of any particular costs, much less costs of particular facilities. They also assert that the Commission did not adopt the position that the 1995 Letter Agreements entitle Northern Natural to reimbursement for the constructed facilities. Cottage Grove and Whitewater state they have in fact negotiated with Northern Natural since December 30, 2003, but they have not reached a resolution and these negotiations are not relevant to the Commission's decision on Northern Natural's request for clarification. They urge the Commission to deny Northern Natural's request for clarification.

42. The Commission finds no improper inconsistency between its treatment of the 2004 Agreement amendments and the 1995 Letter Agreements. The 2004 Agreement amendments are a new filing proposed by Northern Natural under NGA section 4. Northern Natural had the burden to show that the proposal is just and reasonable. It failed to do so for the reasons already discussed. In these circumstances, the Commission was within its rights to reject the proposal, rather than trying to modify it. We were concerned that simply requiring the elimination of the unlawful Nickel Rate from the 2004 Agreement amendments, while accepting the remainder of those agreements, would be unfair to Northern Natural, since that would leave Northern Natural obligated to provide interruptible service in the Field Area at the minimum rate, and we believed Northern Natural's agreement to require Cottage Grove and Whitewater to pay only the minimum interruptible rate was premised on the provision for them to pay the Nickel

[30] December 30 Order at P 74.

[31] *Id*. at P 74-75.

Rate. By contrast, the 1995 Letter Agreements were already in effect. To reject those agreements in their entirety would leave the customers without any service. Also, customers will have to pay the full Nickel Rate for any field Area interruptible service they actually receive.

43. Northern Natural asserts that an essential part of the 1995 Letter Agreements, the paragraph E(3) and E(4) provisions, has been declared null and void and, therefore, that the 1995 Letter Agreements in their entirety are unenforceable or are null and void. On these grounds, Northern Natural requests rehearing of the December 30 Order's requirement that it refile the 1995 Letter Agreements.

44. Northern Natural cites the *Restatement of Contracts, Second* for the proposition that if the performance as to which the agreement is unenforceable is an essential part of the agreed exchange, the inequality will be so great as to make the entire agreement unenforceable. It also cites a case from the Supreme Court of Nebraska. In *Central States Health & Life Company of Omaha v. Miracle Hills Limited Partnership*, 235 Neb. 592, 456 N.W. 2d 474 (1990) (*Central States*), the parties had executed a lease and both had incurred expenditures to improve the property. The lessee had also prepaid rent and utilities expenses. However, the intended use of the property, a printshop, violated the local zoning ordinance and the City of Omaha would not grant the lessee a certificate of occupancy. The lessee was never able to move in. The lessee sought rescission of the lease from its inception and a refund of its expenses. The lessor counterclaimed for expenses for improvements and rent. The court found that the prohibition in the zoning regulations against the intended use terminated the lease and relieved the parties of all obligations under the lease. It held that neither party was entitled to restitution.[32]

45. The Commission has exclusive jurisdiction over whether contract terms violate the Natural Gas Act or Commission policies, regulations, or orders. Therefore, the Commission must decide that issue. However, once the Commission has decided that issue, a court would then have jurisdiction to determine whether the contract requires further payments or should be further modified to accomplish the intent of the parties, consistent with the Commission's holdings concerning what provisions are lawful under

[32] The court stated that "when the parties are asserting rights founded upon an illegal and void contract, the court leaves the parties to such a situation just where they placed themselves and as the court found them." 456 N.W. 2d at p. 478.

Northern Natural's tariff and Commission policy.[33] In this case, the Commission has determined certain provisions of the 1995 Letter Agreements and the 2004 amendments are unlawful in this order and in the December 30 Order. If Northern Natural believes the 1995 Letter Agreements must be modified in light of the Commission's holdings and wishes to seek contractual remedies, it should do so in state court, just as the parties did in the *Central States* case that it cites. Damages and other contractual remedies are a matter of state law.[34] Thus, if Northern Natural desires to seek such relief, it must bring a suit in state court.[35] Northern Natural may not, however, terminate its service to Cottage Grove and Whitewater without abandonment authorization from the Commission pursuant to NGA section 7.

46. The Commission will not find the 1995 Letter Agreements, as modified by the December 30 Order to be null and void. Among other things, this would mean that there would be no current agreements between the parties for firm or interruptible transportation service. Nor will the Commission find that the renegotiation provisions of the 2004 Agreement amendments survive. It is not needed to encourage the parties to negotiate and it would be needlessly confusing.

Compliance Filing

47. On January 31, 2005, Northern Natural filed a revised tariff sheet[36] and other information to comply with the Commission's December 30 Order. Generally, the

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[33] *Williams Natural Gas Co.*, 72 FERC ¶ 61,262 at pp. 62,166-69 (1995) (whether payment violates the Natural Gas Policy Act of 1978 falls under the Commission's exclusive jurisdiction and must be considered first. State court then has jurisdiction to determine whether the contract requires further payments and award damages if warranted.) *Cf. Enbridge Pipelines (KPC)*, 100 FERC ¶ 61,260 at P 375 (2002) (the Commission does not usually take jurisdiction over contract disputes unless they require the special expertise of the Commission, there is a need for uniformity of interpretation, or they are important in relation to the Commission's regulatory responsibilities).

[34] *South Carolina Public Service Authority v. FERC*, 850 F.2d 788, 795 (D.C. Cir. 1988).

[35] *Northwest Pipeline Corp.*, 99 FERC ¶ 61,365 at P 47 (2002) (property values and damages are not issues adjudicated by the Commission, but must be decided in state court).

[36] Substitute Eighth Revised Sheet No. 66C to its FERC Gas Tariff, Fifth Revised Volume No. 1.

Commission directed Northern Natural to (1) revise and file its 1995 Letter Agreements with Cottage Grove and Whitewater consistent with the discussion in the December 30 Order and to file the revised provisions along with the contracts to which they relate; (2) file the underlying agreements for its two FDD service agreement amendments; (3) show cause why its tariff provisions allowing Northern Natural and a shipper to negotiate a capacity release demand charge credit are not unlawful and should not be removed from its tariff and service agreements; (4) remove a potentially discriminatory provision from its FDD service agreement amendments or offer the provision to all shippers through its generally applicable tariff; and, (5) file a revised Sheet No. 66C to reflect only those agreement amendments the Commission accepted.

48. The Commission noticed Northern Natural's filing in the instant proceeding on February 3, 2005, allowing for protests to be filed as provided by section 154.210 of the Commission's regulations. LSP-Cottage Grove, L.P., and LSP-Whitewater Limited Partnership (collectively, LSP) filed a protest and answer, which we discuss below.

A. 1995 Letter Agreements

49. In its December 30 Order, the Commission determined that Northern Natural's 1995 Letter Agreements with Cottage Grove and Whitewater contain certain impermissible provisions, and directed Northern Natural to file revised agreements with the impermissible provisions removed. In its compliance filing, Northern Natural submitted its original 1995 Letter Agreements which included the impermissible provisions, and not the original agreements with the impermissible provisions removed. Northern Natural states that the intent of such renegotiation is to arrive at a rate provision that (1) maintains the intent of the original agreement that Northern Natural build facilities and LSP provide reimbursement for such facilities, and (2) deletes the portion of the rate provision that the Commission found to be impermissible and non-conforming. Northern Natural also requests a 60-day extension of time to renegotiate and file revised agreements.

50. Cottage Grove and Whitewater protest Northern Natural's compliance filing, asserting that by filing the original 1995 Letter Agreements and not revised agreements with the impermissible provisions removed, Northern Natural failed to comply with the Commission's directives in the December 30 Order. Cottage Grove and Whitewater also protest Northern Natural's requested 60-day extension of time to renegotiate new agreements, arguing that such a request is irrelevant to the compliance proceeding and amounts to a request for a stay of the effectiveness of the December 30 Order. Cottage Grove and Whitewater add that nothing in the December 30 Order required the parties to renegotiate new service agreements, let alone within certain time constraints. Cottage Grove and Whitewater assert the Commission should reject Northern Natural's request

for an extension of time and direct Northern Natural to expeditiously file the revised 1995 Letter Agreements in compliance with the December 30 Order.

51. We share Cottage Grove and Whitewater's concerns. Ordering Paragraph (D) of the December 30 Order directed Northern Natural to "revise its 1995 Letter Agreements with Cottage Grove and Whitewater consistent with the discussion in this order and to file the revised provisions along with the contracts to which they relate . . . ." By filing the original agreements that contain impermissible provisions, Northern Natural did not comply with this directive. Accordingly, we direct Northern Natural to file the revised agreements pursuant to the discussion set forth in the December 30 Order. Further, we reject Northern Natural's request for a 60-day extension of time to renegotiate new agreements as moot, since the 60-day period has expired.

B. Underlying Agreements

52. In its December 30 Order, the Commission directed Northern Natural to file for inspection the underlying contracts for Northern Natural's two FDD service agreements that the Commission conditionally accepted. Northern Natural fully complied with this directive by filing the underlying contracts for its FDD service agreements with Cottage Grove and Whitewater.

C. Capacity Release Demand Charge Credits

53. Sections 5(a) of Northern Natural's two firm transportation 2004 Service Agreement amendments provide:

> Shipper agrees that if it utilizes Northern Natural's capacity release program to release, on either a temporary or permanent basis, any capacity subject to the rates contained herein at the rate greater than the rate contained herein, Shipper shall receive a demand charge credit only for the amount of the rate agreed to herein.

54. Northern Natural included a similar provision as section 4 of its FDD service agreement amendment with Whitewater and section 4(a) of its FDD service agreement amendment with Cottage Grove. Northern added these provisions in accordance with sections 47.J(ii) and 58 of its General Terms and Conditions (GT&C). Section 47.J(ii) provides that Northern Natural will give a releasing shipper a credit equal to all demand revenues received from the replacement shipper, unless Northern and the releasing

shipper have agreed to a different credit.[37] Section 58 lists tariff provisions that are permitted in Northern Natural's service agreements and includes a reference to the Demand Credit in section 47.J(ii).[38] These provisions are in addition to those already provided in the *pro forma* service agreements.

55. In its December 30 Order, the Commission found that both section 5(a) and the tariff provisions authorizing Northern Natural to enter into agreements limiting the demand credits provided to releasing shippers may be unjust, unreasonable, and unlawful. The Commission cited Order No. 636-A, which states "a releasing shipper paying discounted rates is entitled to receive proceeds from a release even if such proceeds exceed its reservation fee. This ensures that shippers holding capacity have the incentive to release that capacity when others place a higher value on the capacity than the capacity holders do. The Commission will not limit competition by exempting discounted fixed-rate firm contracts from the capacity release mechanism nor will it permit the pipeline to retain incremental proceeds."[39] The Commission directed Northern Natural to show cause why its capacity release revenue sharing provisions in sections 47.K(ii) and 58 are not unlawful and should not be removed from its tariff.

56. In its compliance filing, Northern Natural provides a brief summary of the Commission's approval of section 47.J(ii) of its GT&C. According to Northern Natural, it proposed this provision as part of its section 4 rate proceeding in Docket No. RP98-203-000. The Commission accepted and suspended the proposal and set it for technical conference. On October 29, 1998, the Commission issued an Order Following Technical Conference[40] accepting the proposal. In that order, the Commission ruled:

> The agreement to share revenues with the releasing shipper, as proposed by Northern, is being proposed in a section 4 rate proceeding consistent with the Commission's policy stated in Midwestern Gas Transmission Co. n.7 Dynegy believes Northern's proposal to recognize shared revenues with a releasing shipper is inconsistent with the Commission's policy to permit a sharing arrangement authority in the context of a section 4 rate proceeding. Several parties express concern regarding Northern's potential for

[37] Substitute Fifth Revised Sheet No. 288, Northern Natural Gas Company, FERC Gas Tariff, Fifth Revised Volume No. 1.

[38] Section 58, Original Sheet No. 309, referencing Sheet No. 288 (Demand Credit).

[39] Order No. 636-A, FERC Stats. & Regs., Regulations Preambles ¶ 30,950 at 30,562 (1992).

[40] 85 FERC ¶ 61,154 at pp. 61,621-22 (1998).

> restricting the secondary market and that Northern has no claim to the releasing shippers' revenues. Northern believes these parties are misconstruing its proposal that is a version of the Commission's policy permitting "marketing fees" relating to capacity release transactions. Northern's sharing proposal is contingent upon the agreement of the parties and is thus optional. However, this proposal may give a shipper more flexibility when negotiating contracts with Northern. Because of this potential flexibility, the Commission accepts this proposal.
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> n.7 84 FERC ¶ 61,097 (1998).

57. Northern Natural argues, based on the Commission's previous findings, the Commission should find its capacity release demand credit provision to be just and reasonable.

58. We accept Northern Natural's explanation as to why the subject provision is permissible in its tariff. The Commission held in Order No. 636-A that a pipeline cannot retain incremental proceeds during a capacity release transaction, but subsequently modified its position. In *Southern Natural Gas Company*,[41] the Commission stated:

> The Commission has provided that existing shippers with discounted reservation rates may release capacity and generally are entitled to receive proceeds from a release, even if such proceeds exceeds [*sic*] their reservation fee. Southern's proposed tariff does not restrict discounted shippers from releasing capacity. It does, however, provide an exception to the crediting of the reservation charges above a discounted rate if such an exception is in the discounted shipper's service agreement with Southern. The Commission finds this provision acceptable since the discounted shipper has entered into this agreement as part of the negotiations to obtain the discount.

59. In *Natural Gas Pipeline Company of America* (*Natural*),[42] the Commission further held that a pipeline may propose a tariff provision to allow it and a shipper to negotiate capacity release revenue, but only as part of a general section 4 rate proceeding: "If Natural and its customers wish to negotiate the rights to capacity release revenues as in *Southern*, Natural would first, in the context of a general Section 4 rate case filing, need

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[41] *Southern Natural Gas Company*, 62 FERC ¶ 61,136 at p. 61,960 (1993).

[42] 82 FERC ¶ 61,298 (1998).

to file the applicable tariff provisions."[43] In *Midwestern*,[44] the Commission reconfirmed that any proposal to incorporate a capacity release revenue sharing provision must be made during a section 4 rate proceeding. Since Northern Natural proposed its capacity release revenue sharing tariff provision as part of its general section 4 rate proceeding in Docket No. RP98-203-000, and since its proposed agreement provisions allowing Northern Natural to collect incremental capacity release revenue are consistent with its tariff, we find the subject provision in Northern Natural's tariff and agreements permissible.

D. FDD Provision Allowing Shippers to Switch Storage Services

60. In its December 30 Order, the Commission conditionally accepted Northern Natural's two Rate Schedule FDD service agreement amendments. Both agreement amendments included a provision that would have allowed the shipper to convert its FDD service to a new or alternative firm storage service over the term of the FDD agreement. The Commission found that such a provision presents too much potential for undue discrimination unless it is offered in the pipeline's tariff pursuant to generally applicable conditions. Accordingly, the Commission directed Northern Natural to either remove the provision from its FDD service agreements, or file a tariff provision proposing the non-discriminatory conditions pursuant to which it proposes to offer such provisions. In its compliance filing, Northern Natural notified the Commission that it is withdrawing its proposed FDD service agreement amendments and that it intends to remove the subject provision from any subsequent FDD service agreements it files in this proceeding.

E. Tariff Sheet

61. In its December 30 Order, the Commission conditionally accepted Northern Natural's Eighth Revised Sheet No. 66C, which sets forth Northern Natural's list of non-conforming agreements, subject to Northern Natural filing a revised sheet reflecting only those agreement amendments that the Commission approved in the December 30 Order. Northern Natural included with its compliance filing a Substitute Eighth Revised Sheet No. 66C listing the original 1995 Letter Agreements on its list of non-conforming

[43] *Id.* at p. 62,176 (1998).

[44] *Midwestern Gas Transmission Company*, 84 FERC ¶ 61,097 at p. 61,501 (1998).

agreements. We accept Northern Natural's tariff sheet effective January 31, 2005, as proposed.[45]

The Commission orders:

(A) The requests for rehearing and clarification are denied as discussed in the body of this order.

(B) Northern Natural's compliance filing is accepted subject to the modifications and conditions in this order.

(C) Northern Natural is direct to file the 1995 Letter Agreements revised pursuant to the discussion in the December 30 Order within 15 days of the date of this order.

(D) Northern Natural's proposed Eighth Revised Sheet No. 66C is accepted effective January 31, 2005.

By the Commission.

(S E A L)

Linda Mitry,
Deputy Secretary.

[45] Even though we are requiring Northern Natural to revise its 1995 Letter Agreements to remove any impermissible provisions, this would not affect the list of non-conforming agreements Northern Natural provides on Sheet No. 66C.