

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Transcontinental Gas Pipe Line Corporation Docket No. RP97-71-021

ORDER ON REMAND

(Issued April 19, 2004)

1. This order responds to the judgment of the United States Court of Appeals for the District of Columbia Circuit (Court) remanding Commission orders that required the Transcontinental Gas Pipe Line Corporation (Transco) to eliminate the impact of a discount rate for Tennessee Gas Pipeline Company (Tennessee) and PSEG Energy Resources & Trade LLC (PSEG)(formerly Public Service Electric & Gas Company (PSE&G)).¹ The Commission determined that the elimination of the impact on rates for other customers was justified because the discount rate was not driven by competition.²

2. Although the absence of competition was shown by several factors, under one of those factors, the Commission found that Tennessee and/or PSEG had agreed to pay the maximum rate for the 20-year duration of the contract if the discount was disallowed. The Court stated that, in fact, PSEG would be liable for the maximum rate only for a three-year period, and not for 20 years, and it could not determine how the Commission would have ruled if it had correctly interpreted the contract. The Court remanded the case to the Commission for further proceedings based on the correct reading of the contract. As discussed below, the Commission finds that the fact that PSEG would be liable for the maximum rate for three, rather than 20, years does not alter the Commission's conclusion that the discount was not required to meet competition.

¹ Public Service Electric & Gas Co. v. FERC, No. 01-1144, 37 Fed. Appx 544, 2002 U.S. App. LEXIS 11363 (D.C. Cir. May 28, 2002).

² Transcontinental Gas Pipe Line Corp., 90 FERC ¶ 61,279 (2000), order on reh'g and compliance filing, 94 FERC ¶ 61,066 (2001)(Transco).

Background

3. Under a service arrangement originally certificated in 1954, Transco offered transmission service to Tennessee under Rate Schedule X-15 on behalf of PSEG at a flat rate of \$200,000 per year under a 20-year contract.³ Historically, Transco did not allocate costs to Rate Schedule X-15 or include the X-15 volumes in its billing determinants. Instead, Transco reflected the \$200,000 annual revenue as a credit to its transmission cost of service. In 1991, Transco, Tennessee, and PSEG entered into a new arrangement for essentially the same service for a period of 20 years at an increased flat rate of \$1.26 million per year. Nonetheless, the new rate still represented a \$2 million discount compared to the \$3.3 million the service would have yielded under Transco's otherwise applicable Zone 6 maximum Part 284 rate. Transco treated the service under the 1991 agreement as a discounted transaction, including it in monthly discount reports to the Commission.

4. The 1991 agreement contains a Risk Allocation Agreement under which, if the Commission required Transco to eliminate the effect of the discount on other customers by imputing more revenue to the Tennessee/PSEG service, Transco could charge Tennessee and PSEG the higher rates. Section III.B. of the Risk Allocation Agreement reads:

From the date of the FERC order imputing rate/revenues, prospectively, Transco will charge the higher rate levels imputed by the FERC under the FT agreement.

1. PSE&G agrees to bear responsibility for such increased charges until the effective date of Tennessee's next rate case but in no event greater than three years.

2. Tennessee agrees to bear responsibility for such increased charges prospectively from the effective date of such Tennessee rate case unless earlier as provided for in III.B.1. It is understood that Tennessee reserves its rights to recover such charges from its customers, including PSE&G.

5. The 1991 agreement was never filed with the Commission because, according to Transco, it resolved no legal issues pending before the Commission at that time.⁴ When Transco sought to abandon the pre-existing PSEG service to provide the transportation under the 1991 agreement, it requested a waiver of the open season requirement prior to

³ The historical background of this discount was set forth in detail in the prior order. 90 FERC at 61,937-39.

⁴ Transco, 90 FERC at 61,939.

abandonment. The Commission granted the waiver and approved the replacement service in 1992.⁵

6. In its first two rate cases following the 1991 agreement, Transco continued its historic practice of not including the billing determinants associated with the PSEG/Tennessee service in its rate design volumes and reflect the annual revenues as a credit to its transmission cost of service. In this rate case, Transco proposed to continue that practice. However, Consolidated Edison Company of New York, Inc. (Con Ed), supported by the Commission staff, contested this rate treatment of the service, arguing that a discount was not required by competitive circumstances, and that the revenue crediting ratemaking treatment resulted in other customers unfairly subsidizing the discount.

7. An Administrative Law Judge resolved the question based on the burden of proof, finding that Con Ed's evidence was insufficient to overcome a presumption that the discount was offered to meet competition, and that it failed to show that benefits flowing from other terms of the agreement were insufficient to justify the discount.⁶ The Commission reversed. The Commission found that Transco's existing rate treatment of the Tennessee/PSEG service is unjust and unreasonable since the revenue credit results in the rates paid by Transco's other customers subsidized the service to Tennessee/PSEG. Transco and PSEG sought to justify the current rate treatment of the Tennessee/PSEG service under the Commission's policy regarding discount adjustments to the pipeline's rate design volumes. Under those policies, when a pipeline is required during the test period for a rate case to provide a discount to meet competition, the pipeline need not design its rate on the assumption that such discounted volumes would flow at the maximum rate. One way of accomplishing this is to credit revenues from the discounted transaction to the cost of service similar to Transco's existing rate treatment of the Tennessee/PSEG transaction. However, the Commission found that: the discount to Tennessee/PSEG was not justified by competitive circumstances; whatever benefits that might have been provided to Transco's customers in the past, no longer existed; and the discount should no longer be subsidized by other customers.⁷ In the order, one factor relied upon by the Commission was that PSEG and/or Tennessee had agreed to pay any Commission-ordered higher rates for the remainder of the 20-year term of the contract.⁸

⁵ See Transcontinental Gas Pipe Line Corp., 58 FERC ¶ 61,229 (1992).

⁶ See Transcontinental Gas Pipe Line Corp., 86 FERC ¶ 63,013 (1999).

⁷ Transco, 90 FERC at 61,943-44.

⁸ Id.

8. On rehearing, the Commission stated:

Most importantly, the “Risk Allocation Agreement” in the contract with Tennessee/PSE&G shows their willingness to pay the maximum rate if that was necessary to retain their capacity on Transco. That agreement provides that prospectively from the date of any Commission order imputing a higher FT rate to the service, the discount would end and “Transco will charge the higher rate levels imputed by FERC under the FT agreement” of the remainder for the 20 year term of the contract.⁹

9. On appeal, the Court referred to the quoted language as an indication that the Commission’s orders were based on its understanding that PSEG would pay higher rates for the 20-year contract when PSEG had actually limited that obligation to a three-year maximum. The Court stated that because the Commission based its decision on a fact that turned out to be wrong, it could not say how the Commission would have ruled in absence of that factor. Therefore, in an unpublished opinion, it remanded the case to the Commission for further proceedings based on the correct reading of the contract.

Subsequent Filings

10. On April 14, 2003, PSEG filed a motion requesting expedited action on the remand and an order directing refunds. Transco filed an answer to PSEG’s motion. PSEG contends that the Court determined in its May 28, 2002 judgment that the Commission erred in the underlying proceedings when it directed Transco to change its ratemaking treatment between Transco and PSEG. PSEG argues that, as correctly read by the Court, it agreed to pay maximum rates for at most a three-year period. It points out that it never agreed to pay maximum rates over the remaining life of the 20-year agreement. PSEG claims that under a correct reading of the contract, Transco’s agreement to provide a discount to PSEG for a multi-year period was in fact required to meet competition. Therefore, PSEG concludes that, based on Commission policy, the PSEG discount is entitled to the ordinary presumption of validity accorded discounts given by a pipeline to a non-affiliate. As such, PSEG surmises that Transco is entitled to treat the PSEG discount for ratemaking purposes as it would any other discount.

11. PSEG requests that the Commission: (1) exercise its power and discretion under section 16 of the Natural Gas Act to set aside Transco’s rates because the prior rate determination was erroneous; (2) direct Transco to restore its historic ratemaking treatment of the discount at issue prospectively, effective June 1, 2003, or as soon as reasonably possible; (3) direct Transco to refund PSEG the increased amount PSEG has been unlawfully required to pay since February 1, 2002, with interest; and (4) authorize

⁹ Transco, 94 FERC at 61,281-82.

Transco to make a prospective, one-time billing adjustment to recover the cost of amounts it is required to refund to PSEG from Transco's other shippers.

12. In its answer, Transco supports PSEG's position that the appropriate action on remand is for the Commission to reverse its determination with respect to the rate treatment of the for PSEG's service. It also asserts that if the Commission does require Transco to refund PSEG, with interest, the amounts collected in excess of the preexisting discount, that the Commission allow Transco to recover those amounts from its shippers.

Discussion

13. Under the Commission's discount policy, the relevant inquiry is whether the pipeline would lose the business without a discount due to competitive alternatives.¹⁰ Such a loss would deprive other pipeline customers of the contribution to fixed costs that would otherwise result from the discounted rate, and justify their subsidy to retain the business.¹¹

14. In the March 17, 2000 Order on the initial decision and the January 24, 2001 Rehearing Order, the Commission found, among other things, sufficient evidence to rebut a presumption that the rate treatment afforded Tennessee and PSEG was necessary to meet competition. One of the factors considered in that decision was that Tennessee and PSEG had agreed to pay the maximum rate to retain their capacity on Transco "for the remainder of the 20 year term of the contract".¹² On appeal, PSEG argued that its responsibility to pay the maximum rate was limited to three years and the Court remanded the case based on PSEG's limited liability. We find that PSEG's agreement to limit its risk to pay Transco's maximum rate for three years does not undermine the Commission's finding that the discount was not compelled by competition.

15. Under section III.B.1. of the 1991 agreement, PSEG is responsible for any increase "until the effective date of Tennessee's next rate case but in no event greater than three years." Under section III.B.2. of the 1991 agreement, Tennessee is responsible for any increase "prospectively from the effective date of such Tennessee rate case unless earlier as provided for in III.B.1." Therefore, while PSEG only agreed to pay the maximum rate for three years, under section III.B.2. Tennessee bore the responsibility to pay the maximum rate for the remainder of the 20-year term of the contract.

¹⁰ See *Algonquin Gas Transmission Co.*, 104 FERC ¶ 61,118, at P 44 (2003); *Williston Basin Interstate Pipeline Co.*, 85 FERC ¶ 61,247, at 62,028 (1999).

¹¹ *Id.*

¹² *Id.*

16. In the March 17 and January 24 Orders, the Commission found that the Risk Allocation Agreement shows Tennessee's and PSEG's combined willingness to pay the maximum rate if that was necessary to retain their capacity on Transco for the remaining 20-year term of the contract. The agreement of Tennessee and PSEG as co-shippers to assume liability to pay the maximum rate if the Commission disallowed the discount was the basis for the Commission's finding that the Risk Allocation Agreement shows that the discount was not granted to meet competition. The Commission recognizes that liability to pay the maximum rate was apportioned between these co-shippers so that PSEG is responsible to pay the increase for three years, and Tennessee for the remainder of the contract. But, this apportionment of responsibility between the co-shippers does not affect the underlying finding that the Risk Allocation Agreement supports a conclusion that the discount was not based on competition and was not required to retain Tennessee and/or PSEG on Transco's system. A customer's affirmative agreement to pay the maximum rate, whether for three or 20 years, rather than retain the freedom to walk away unless the discount remains part of the deal, is inconsistent with its having a competitive alternative and inconsistent with the conclusion that the discount was necessary to retain the business.¹³ The Risk Allocation Agreement shows that the discount was not necessary to retain the business of these shippers since they agreed to remain on the system for the entire term of the agreement without the discount.

17. As stated in the rehearing order, the evidence in the record in this proceeding, taken as a whole, supports the conclusion that the discount given to Tennessee/PSEG was not and is not require by competition.¹⁴ In addition to the Risk Allocation Agreement factor, the Commission found no evidence that Tennessee and/or PSEG have alternatives to the Transco service that it could use if it were unwilling to pay the maximum rate. Further, Transco capacity was fully booked and did not offer any discounts to other shippers in Zone 6.¹⁵ Therefore, if PSEG decided to leave the system, it is reasonable to conclude that Transco could resell the capacity at the maximum rate. In these circumstances, even if PSEG did terminate its contract, Transco's existing customers would not be deprived of a contribution to the fixed costs of the pipeline. Accordingly, there is no justification for Transco's existing customers to subsidize the Tennessee/PSEG discount.

¹³ We note that section I.B.5. of the 1991 agreement allows the parties to terminate the agreement with three years written notice.

¹⁴ Transco, 94 FERC at 61,283. In fact, the evidence indicated that the consideration for the discount rested on the resolution of other disputes between Transco and Tennessee. Id.

¹⁵ Id., at 61,282.

18. Moreover, as a result of the Commission's orders, Transco's shippers are not required to subsidize the cost of an unreasonable discount, nor are Transco's shareholders required to absorb the costs of any discount. Transco's existing customers will not subsidize any Tennessee/PSEG discount since the Commission required a full allocation of costs to the Tennessee/PSEG contract. In addition, Transco's contract with Tennessee and PSEG provides Transco the opportunity to raise their rate to the maximum Commission approved rate for the service. Thus, under the agreement, Transco can receive full cost recovery and is generally not responsible for any increase charges.¹⁶ Therefore, neither Transco, nor its existing customer or its shareholders, will be responsible for any additional costs as a result of our order in this case. The Tennessee/PSEG agreement has a provision that specifically determines who is responsible to pay the difference between the maximum rate and the rate agreed to between Transco, Tennessee, and PSEG. Specifically, under the Risk Allocation Provision, Tennessee and PSEG are to bear the responsibility for any increased charges from the date of the Commission order forward. In essence, the issue in this case is one of risk sharing between Tennessee and PSEG and not cost recovery between Transco's customers and shareholders.

19. As discussed above, we find that the Risk Allocation Agreement provides that either PSEG or Tennessee is willing to pay the maximum rate for the full term of the contract. Therefore, the Commission's findings in the March 17 and January 24 Orders are affirmed. Further, the Risk Allocation Agreement was just one of many factors that we find demonstrate that the proposed discount was not driven by competition. Accordingly, PSEG's motion requesting an order directing refunds is denied.

The Commission orders:

- (A) The Commission affirms its findings in the March 17 and January 24 Orders.
- (B) PSEG's motion is denied.

By the Commission. Commissioner Kelly not participating.

(S E A L)

Linda Mitry,
Acting Secretary.

¹⁶ Transco is responsible under section III.A. for one-third of the increased charges between the effective date of the rate case to the date an order is issued. Since, we have acted under NGA section 5, we have made our decision effective prospectively only from the date of the order.