108 FERC ¶ 61,044
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Northern Natural Gas Company Docket No. RP04-155-001

ORDER ON COMPLIANCE FILING

(Issued July 12, 2004)

1. On March 15, 2004, Northern Natural Gas Company (Northern Natural) filed a compliance filing, including revised tariff sheets,[1] in response to the Commission's February 27, 2004 order in this proceeding.[2] The Commission accepts the compliance filing effective August 1, 2004.

I. Background

2. On January 30, 2004, Northern Natural filed tariff sheets in the instant docket that, among other things, purported to clarify its procedures for conducting right-of-first refusals (ROFR) for storage capacity under its Firm Deferred Delivery (FDD) Service. The proposal permitted third party shippers to make bids on different packages of FDD capacity[3] that may have become available within the same 45 day open season timeframe. The January 30 proposal also required that any third party shipper submitting multiple bids prioritize those bids by identifying the specific packages of capacity to which each bid was directed. Northern Natural would determine the highest bid that the original shipper must match by comparing the priorities of the bids submitted against the package held by the original shipper. An original shipper holding a package that was subject to a right-of-first refusal was required to exactly match the rate and term of the competing bid

[1] Substitute Second Revised Sheet No. 298 and Substitute Fifth Revised Sheet No. 299A.

[2] Northern Natural Gas Company, 106 FERC ¶ 61,195 (2004).

[3] The term "package" means the capacity that becomes available under a particular storage contract and is subject to an ROFR. Thus, a single shipper could have multiple packages of capacity that became available in the same open season.

having the highest economic value as determined by Northern Natural. This would be done in 15 days, and if the competing bid was for a lesser quantity than the capacity held by the original shipper, then the original shipper was required to provide a notice to Northern Natural stating what capacity it desired to retain. The balance of the January 30, 2004 filing contained a wide range of other rate proposals not relevant here.

3. The Commission accepted and suspended the January 30, 2004 filing with a full five month suspension, to be effective August 1, 2004, and required Northern Natural to provide revised tariff sheets clarifying the portion of that filing that addresses the ROFR for its FDD service. The Commission concluded that the tariff language did not clearly establish whether third party bidders submitting bids for FDD capacity held by the original FDD shipper would be permitted to submit multiple bids for the same package of capacity, whether Northern Natural could present the original shippers with bids from several third parties, which packages those shippers might have to match, and if so, how the matching would take place. The Commission also stated that the economic and operating justification for the proposal was unclear, and that certain aspects of the proposal did not appear to conform to overall Commission policy regarding ROFRs. The Commission therefore required Northern Natural to clarify that the original shipper was not required to match the quantity of the existing bid, but only the value based on the rate level and term.[4]

II. The Instant Compliance Filing

4. On March 15, 2004, Northern Natural filed the required clarification in the form of two revised tariff sheets and an explanation of the mechanics of its proposal. First, Northern Natural added language to its tariff clarifying that third party bidders may bid on one or more packages of FDD capacity, but may only submit one bid against each package of capacity that is subject to an ROFR. If such a bidder submits more than one FDD package, the bidders must prioritize their bids and indicate a minimum and maximum total cycle quantity desired. Northern Natural included tariff language that also clarified that the following procedural aspects of its proposal: (1) that it would notify the original FDD shipper of all the third party bids received for its capacity within five business days of the close of the bidding process; (2) that the original FDD shipper must provide written notice within fifteen days of the date of Northern Natural's notification identifying the bids the original FDD shipper is willing to match, but that shipper is not required to match all such bids; (3) that Northern Natural will then determine the best offer that the original shippers must match based on the priority provided by the bidders and the matching elections provided by all the original FDD shippers holding an ROFR; (4) that if the original FDD shipper agreed to match the best bid Northern Natural determined it must match, then Northern Natural will tender a contract for the capacity to that shipper; otherwise, Northern Natural will tender a contract to the chosen third party

[4] *Id.* P 24 and 25.

bidder; and, (5) that the shipper with the winning bid must execute any tendered service agreement within fifteen days. Northern Natural also included a detailed mathematical example of how the proposal would work and made the other changes to its proposal required by the February 27, 2004 order. This included the provision that the original shipper holding the ROFR must match the price and term, but need not match the quantity, of the competing bids.

5. Northern Natural's detailed explanation of its proposal starts from the proposition that storage capacity is homogeneous. This is because it is all located at the same point. Therefore, unlike bids submitted in a ROFR process involving mainline transportation capacity, bids for storage capacity cannot be differentiated by the receipt and delivery points of the service. To summarize the concept, if two contracts for storage capacity are expiring and the original shippers each have a ROFR, a third party whose capacity needs can be satisfied by obtaining either package may want to submit bids for each package. The third party has varying prospects that a bid for either package would be accepted depending on the relative present value of all the bids submitted by competing third party bidders for the package in question and what value each original shipper is willing to match. As such, given the homogeneous nature of storage service, the third party could maximize its chances of obtaining the capacity it needs by submitting bids for each of the available packages.

6. Northern Natural states that its revised language should resolve these complexities by requiring shippers to prioritize which of packages they are bidding against and under what terms. To simplify the example contained in Northern Natural's filing, assume that two packages of FDD capacity become available simultaneously, one held by original shipper Y with a capacity of 500 (Package A) and one held by original shipper Z of 300 (Package B). Two third parties bid. Third party A submits one bid for 300 Dth for four years at the maximum rate. Third party B submits one bid of 500 Dth for three years, also at the maximum rate. All bids are at the maximum rate and each shipper specifies the priority of the packages it is bidding against. In this case, third party A selects Package A as the first priority and Package B as the second priority, as does third party B. Both third parties have submitted only one bid against each package, with the same rate, volume, and term in each bid, as required by Northern Natural's proposal. Original Shipper Y holding Package A of 500 Dth is willing to match any bid with a term of one year at the maximum rate; Original Shipper Z holding Package B of 300 Dth will match a bid of any term for 200 Dth, and will match for one year a bid for 100 Dth, both at the maximum rate.

7. The results are as follows. Regarding Package A of 500 Dth, third party A has bid for 300 Dth of capacity for four years and third party B has bid for 500 Dth of capacity for three years, both at the maximum rate. Original Shipper Y will match for only one year, and therefore will not match the bids of either third party A or B. As such, of the 500 Dth Package A, Original Shipper Y receives no capacity, 300 Dth are awarded to

third party A for four years and 200 Dth are awarded to third party B for three years. At this point, third party A has met all its requirements based on its four-year bid and its selection of Package A; third party B has met its requirement for 200 out of the 500 Dth it desires on the basis on its three-year bid, also against Package A.

8. At this point, there are 300 Dth remaining in Package B which might satisfy third party B's desire for an additional 300 Dth of FDD capacity, since that shipper selected Package B as its second priority. However, Original Shipper Z is willing to match any bid for 200 Dth of those 300 Dth. Thus, the Original Shipper Z matches third party B's bid for 200 Dth for three years, which leaves another 100 Dth still available in Package B. However, since the Original Shipper Z is only willing to bid one year for the remaining 100 Dth and third party B is willing to bid three years, the remaining 100 Dth are awarded to third party B. Original Shipper Z fails to obtain 100 Dth of the total of 300 Dth it desired, since Original Shipper Z is unwilling to match a bid with a term in excess of one-year for those 100 Dth of capacity. Third party B fails to obtain 200 Dth out of the total of 500 Dth it desired, because it is unwilling to bid for a term longer than three years for that capacity, whereas the other shippers are.

III. <u>Notice and Protests</u>

9. Notice of this compliance filing issued on March 19, 2004, with protests due as required by section 154.210 of the Commission's Regulations. On March 29, 2004, the Northern Municipal Distributors Group and the Midwestern Region Task Force Association (the Protestors) filed a joint protest. Northern Natural filed for leave to file an answer and an answer on April 13, 2004. The Commission finds that the answer provides additional information that helpful to the resolution of this proceeding and accepts that answer.

IV. <u>Discussion</u>

10. The Protestors assert that Northern Natural's proposal is discriminatory and at best would result in the awarding of many small packages. They therefore urge that the Commission to permit a third party shipper desiring to submit a competing bid against a package that is subject to a right-of first refusal should be permitted to submit only one bid against one package, rather than allowing the submission of bids for several different packages. In its answer, Northern Natural asserts that it would be discriminatory not to adopt the practice just described because failure to do so would deprive shippers of much of their opportunity to obtain capacity. Thus, in the example previously discussed, if a competing third party B could bid only against Package A held by Original Shipper Y, it would receive only 200 Dth out of the total of 500 Dth it desires, and could not obtain any of the capacity available in Package B, even though it places a higher value on that capacity than Original Shipper Z. If third party B were permitted to bid only against Package B held by Original Shipper Z, it could not obtain any of the Package A capacity,

even though it values 200 Dth of that capacity more than any other shipper, and as a result it would obtain only 100 Dth out of the total of 500 Dth it desires. By contrast, under the proposal developed by Northern Natural, third party B is able to obtain at least 300 Dth of the total of 500 Dth it would consider economical because it is able to submit one bid against each of two packages having at least 300 Dth. It thus is able to obtain all of the capacity that it values more than any other shipper.

11. Moreover, Northern Natural asserts that its structure permits it to maximize the value of the capacity, which is consistent with Commission policy. This is because the Original Shippers Y and Z must both match competing bids for their capacity under the ROFR process. In contrast, absent the structure Northern Natural proposes, if third party B bids only against Package A, Original Shipper Z has no need match the market value for 200 Dth even though it is willing to do so. If third party B bids only against Package B, Original Shipper Y avoids the necessity of paying a market rate for 200 Dth of capacity for more than one year. A structure that assures that capacity will go to the shipper that values it most and that maximizes the value of the capacity to the pipeline is a fundamental component of Commission policy governing the allocation of capacity.

12. The Commission accepts Northern Natural's explanation of its proposed tariff language and the revisions contained in its March 15, 2004 compliance filing. As the example demonstrates, each shipper bidding to obtain capacity maximizes its opportunity to bid at the value acceptable to it for each package of the capacity that becomes available during the open season, and none of their potential bids are nullified because they cannot bid against a portion of that capacity. Of equal importance, no original shipper seeking to retain capacity is required to bid more than is necessary (given the value it is willing to pay) to retain a package of capacity. Consistent with Commission policy, the capacity is valued based on the amount any of those shippers is willing to pay for the capacity. Therefore the Commission accepts Northern Natural's proposed tariff language.

<u>The Commission orders</u>:

Northern Natural's proposed Substitute Second Revised Sheet No. 298 and Substitute Fifth Revised Sheet No. 299A are accepted, effective August 1, 2004.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.