UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Gas Transmission Northwest Corp. Docket No. RP02-362-006

ORDER ON REMAND

(Issued November 3, 2004)

1. This case is before the Commission on remand from the United States Court of Appeals for the District of Columbia Circuit.[1] At issue is an unsubscribed capacity (or "prearranged deal") program proposal by Gas Transmission Northwest Corporation (GTN) that would allow shippers on a natural gas pipeline to reserve capacity beginning at a future date, and, in particular, GTN's related request for waiver of the right of first refusal applicable to shippers who reserve capacity in the interim. This order approves GTN's proposed waiver of the right of first refusal, subject to conditions.

2. This order ensures that a pipeline denying rights of first refusal does so without undue discrimination or preference, consistent with its tariff.

BACKGROUND

GTN's Prearranged Deal Program

3. In two filings submitted to the Commission, GTN proposed a new program to allow it to sell available, unsubscribed capacity, or capacity expected to become available (and not subject to an existing right of first refusal), to a shipper willing to execute an agreement for service to start at a specific date up to three years in the future in a "prearranged deal."

4. Under section 18 of GTN's tariff, GTN posts available capacity for a bidding period (or open season) of one to five business days depending upon whether capacity is

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[1] *Gas Transmission Northwest Corp. v. FERC*, 363 F.3d 500 (D. C. Cir. 2004) (*GTN*).

available for up to a month or a year of more. GTN evaluates the bids on a net present value basis. If no bid satisfies the open season criteria, then GTN will post capacity on its website as available unsubscribed capacity and award capacity on a first come, first served basis to shippers that offer the maximum rate or acceptable discounted or negotiated rates.

5. In its prearranged deal filings, GTN proposed to amend section 18 to allow GTN to sell two categories of capacity on a prospective basis: (1) capacity expected to become available at some future date, prior to when it typically would be subject to an open season posting, or (2) capacity that is currently posted as unsubscribed capacity (which previously has been subject to an open season process).[2] In either case, the capacity would not already be subject to a right of first refusal. This prearranged deal could commence up to three years into the future. Under the proposal, GTN would post on its Internet website, one year prior to the commencement date of a prearranged deal, a notice that the capacity associated with the pre-arranged deal will be subject to GTN's open season bidding process, and that the open bidding will commence no later than three months prior to the in-service date of the pre-arranged deal. If another party submits a higher value bid during open bidding, the prearranged shipper would have an opportunity to match that bid. In addition to posting all currently available capacity, GTN proposed separately identifying on its website all capacity anticipated to become available within the next thirty-six months. The modified language also required GTN's pre-arranged agreements to have a minimum term of five years.

6. GTN also would offer capacity subject to a prearranged deal to shippers seeking to purchase the same capacity in the interim (these shippers are referred to as "interim shippers"). GTN proposed denying the right of first refusal to interim shippers that secured capacity of one year or more.[3]

Prior Commission Orders

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[2] Additionally, GTN proposed that if there is an ongoing open season for capacity, GTN would not enter into a pre-arranged deal for that capacity during the open season.

[3] The Commission's Rules require pipelines to provide firm maximum rate shippers holding contracts of one year or more a right of first refusal to renew their contracts and continue service. 18 C.F.R. § 284.221(d) (2004). The right of first refusal protects gas customers from pipeline exercise of monopoly power by allowing captive customers served by a single pipeline to match competing bids and retain long-term firm transportation service. *See United Distribution Cos. v. FERC,* 88 F. 3d 1105, 1140 (D. C. Cir. 1996).

7. The Commission approved GTN's proposal, with three modifications.[4] First, the Commission noted that that GTN's tariff does not allow GTN to award capacity before the conclusion of the open season, and directed GTN to clarify its tariff to provide that before it enters into a pre-arranged deal for capacity becoming available in the future, it will post the availability of such capacity to afford potential shippers an equal opportunity to acquire the capacity. Second, the Commission objected to the mandatory five-year minimum contract term as an unduly discriminatory condition of service, and directed GTN to remove this provision.

8. Finally, the Commission rejected GTN's request for a waiver that would allow it to deny a right of first refusal to interim shippers purchasing capacity of more than 12 months in duration. GTN had argued that the Commission should waive the right of first refusal to interim shippers because the prearranged deal program was analogous to the Commission's other "capacity reservation" proceedings, in which the Commission approved the waiver. Under the capacity reservation precedent, a pipeline may reserve capacity for future expansion projects and as long as the pipeline meets certain conditions the right of first refusal is waived for capacity sold in the interim. The need for such reservations of capacity may arise when a pipeline with excess capacity in one part of its system plans an expansion to remedy anticipated constraints in another part. In such cases, the Commission has allowed pipelines to reserve existing unsubscribed capacity for a temporary period so that the capacity can be included as part of a future expansion project.[5] The purpose of the reservation is to allow planning to take place, without having a moving target as to how much of the existing system can be used in conjunction with the expansion. The Commission has found that such "reservation of capacity will minimize facility construction and associated environmental impacts, will encourage fuller utilization of capacity, and will minimize the rate impact of allocating costs of unsubscribed capacity to existing customers once the expansion is completed."[6]

9. Once the capacity is reserved, the Commission requires pipelines to market the

[4] *PG&E Gas Transmission, Northwest Corp.*, 100 FERC ¶ 61,040 (2002) (accepting the initial proposal); *PG&E Gas Transmission, Northwest Corp.*, 102 FERC ¶ 61,044, *reh'g denied,* 103 FERC ¶ 61,061 (2003) (accepting in part and rejecting in part subsequent revisions to the initial proposal).

[5] *See, e.g., Iroquois Gas Transmission Sys.*, 100 FERC ¶ 61,279 at P 5 (2002) (*Iroquois*); *Northwest Pipeline Corp.*, 85 FERC ¶ 61,335 at 62,312 (1998).

[6] *Northwest Pipeline Corp.*, 85 FERC ¶ 61,335 at 62,312 (1998).

reserved capacity on an interim basis, *i.e.*, until it is needed on a more permanent basis by expansion shippers. The Commission has waived its ROFR regulation for such capacity during the interim period, reasoning that interim shippers' exercise of ROFR rights would defeat the point of reserving the capacity.[7] An important component of the capacity reservation program is the existence of numerous safeguards that ensure that the pipeline is not reserving capacity to exercise market power. These include requiring that capacity to be reserved must be unsubscribed capacity that the pipeline has been unable to sell in its current configuration;[8] allowing the pipeline to reserve capacity only for one year before filing for a certificate, and thereafter until either the project goes into service, the application is withdrawn, or the application is denied;[9] and requiring the pipeline to conduct an open season for the expansion and give existing shippers an opportunity to turn back their capacity as an alternative to expansion or to minimize the size of expansion.[10]

10. The Commission disagreed with GTN's analogy to the capacity reservation precedent, noting that unlike the capacity reservation context, under the GTN proposal there is no specified system expansion project. The Commission noted that GTN was proposing to insulate itself from its decision to enter into prearranged deals at the expense of interim shippers, and explained that a shipper wishing to secure capacity at a future date can address the risk that the capacity will be unavailable at a later time by purchasing capacity now and releasing it until it has a use for it.

11. On rehearing, the Commission responded to GTN's argument that greater efficiency would result by acknowledging that although efficiency is a concern, there remained the more significant concern for protecting long-term maximum rate customers from pipelines' exercise of market power. The Commission also explained that the denial of the waiver did not defeat the usefulness of the prearranged deal program because interim shippers purchasing less than 12 months of capacity have no right of first refusal under the Commission's regulations.

<u>Remand By The Court</u>

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[7] *Tennessee Gas Pipeline Co.*, 84 FERC ¶ 61,304 at 62,394-95 (1998), *order on reh'g*, 86 FERC ¶ 61,066 (1999).

[8] *Northern Natural Gas Co.*, 105 FERC ¶ 61,057 at P 13 (2003), *reh'g denied*, 107 FERC ¶ 61,072 (2004).

[9] *Columbia Gas Transmission Corp.*, 101 FERC ¶ 61,380 at P 17 (2002).

[10] *Northern Natural Gas Co.*, 105 FERC ¶ 61,057 at P 18, 30 (2003), *reh'g denied*, 107 FERC ¶ 61,072 (2004).

12. On review, the court concluded that the Commission did not provide a reasoned basis for distinguishing the capacity reservation cases, in which the waiver was granted, and this proceeding, in which the waiver was denied. The court was persuaded that the capacity reservation cases served similar goals as the prearranged deal program. Specifically, the court agreed with GTN's argument that the prearranged deal proposal is similar to the capacity reservation program because "avoiding wasteful use of existing capacity obviates or reduces the need for additional, potentially wasteful construction, precisely the object of the capacity reservation program." [11] The court sought what it concluded the Commission had not supplied – a "compelling distinction between the two contexts."[12]

<u>GTN's Post-Remand Filing</u>

13. Finally, after the issuance of the court's opinion, GTN filed a letter in this proceeding on May 14, 2004 that makes two points. First, GTN explains that its proposed waiver will further infrastructure development because it is designed to allow GTN to prospectively sell capacity to shippers with defined service needs and long lead times, such as greenfield electric generation projects or local distribution companies anticipating load growth. These generation projects, GTN explains, require firm transportation contracts as a precondition to securing financing. And the Commission's suggestion that shippers needing future capacity acquire it and then release it until it is needed is not a practical alternative because greenfield generation projects, for example, are not financially positioned to acquire capacity in this manner.

14. Second, GTN reiterates the argument it made on appeal – that the prearranged deal proposal is similar to the capacity reservation program because it will help ensure that future expansion projects are both necessary and properly sized. Without a waiver, "the only way that GTN would be able to guarantee capacity on a prospective basis would be to commit to constructing additional capacity to serve a prospective capacity need, whether or not such additional capacity is ultimately necessary."[13]

<u>DISCUSSION</u>

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[11] *GTN*, 363 F.3d at 503.

[12] *Id.*

[13] GTN letter at 4.

15. The Commission will approve GTN's prearranged deal program, and, in particular, the waiver of the right of first refusal, subject to further conditions described below. Permitting a pipeline to sell capacity for service to commence in the future has efficiency benefits similar to some of those in the capacity reservation program, as GTN argues, and will benefit customers with long lead times who do not need capacity right now, but need assurance that they can get capacity in the future. For these reasons, we will allow GTN to enter prearranged deals and sell capacity in the interim without a right of first refusal, but under conditions similar in purpose and design to those applied in the capacity reservation context. The conditions ensure the program's consistency with the other provisions of GTN's tariff concerning the allocation of capacity, provides other shippers the opportunity to bid on the future capacity before it is reserved for a particular customer, and awards capacity to a customer that places the highest net present value on the capacity.

16. As proposed, GTN could enter into a prearranged deal for service to commence up to three years in the future. However, it would not be required, until one year prior to the commencement date of a prearranged deal, to post a notice that the capacity associated with the pre-arranged deal will be subject to GTN's open season bidding process, and the open bidding then would not be required to commence until three months prior to the in-service date of the pre-arranged deal. This delay in the posting of the prearranged deal for competing bids raises two problems. First, GTN's agreement to a prearranged deal with a particular shipper could lead to a withholding of capacity for sale on a long-term basis for a period of close to three years without there being any bidding process to allow other shippers to obtain the capacity on a long term basis. This is contrary to what the Commission has done in the capacity reservation context, where the Commission requires the pipeline to conduct a pre-reservation posting for the capacity indicating that the pipeline intends to reserve the capacity and giving any one who wants the capacity in the pipeline's current configuration an amount of time to buy it.[14] Second, by delaying the bidding process until no later than three months before the commencement of service, the pipeline gives the prearranged deal shipper only a right of first refusal, and not a contractual right that secures the capacity. Because it is important for shippers such as new or planned electric generators to have rights to capacity to secure financing, then that right should be an enforceable right that clarifies the price of that capacity, and not a right

that merely provides the opportunity to match a competing bid. The Commission also

[14] *Northern Natural Gas Co.*, 105 FERC ¶ 61,057 at P 13 (2003), *reh'g denied*, 107 FERC ¶ 61,072 (2004).

rejects these procedures because they do not apply the net present value pricing method used in GTN's tariff.

17. Therefore, the Commission will permit GTN to enter a prearranged deal with a shipper for service to commence at some time in the future.[15] However, the pipeline must post the prearranged deal as soon as it is entered into to permit other parties an opportunity to bid for the capacity on a long-term basis with a right of first refusal, rather than waiting until a later time, as under GTN's proposal. This open season bidding process should take place even if capacity already has been subject to an open season and currently is posted as available. Any third party wishing to purchase the capacity, whether for service commencing immediately or in the future, could then participate in the open season. The bids would be evaluated on a net present value basis. In calculating net present value, the current value of the future bid would be reduced by the time value of the delay in the pipeline receiving that revenue. If a competing bid for service to commence immediately or in the future provides a higher net present value than the prearranged deal, the pipeline would give the prearranged shipper a one-time right to match the bid. Once future capacity is awarded, any interim long term capacity would then be available without a right of first refusal.

18. This bidding process seeks to ensure that at the time of the request for prearranged capacity, there is no other shipper wishing to purchase the capacity either immediately or in the future that would place a higher value on the capacity. Therefore, this approach allows a more efficient allocation of capacity and ensures that the capacity is awarded to the party willing to pay the highest net present value for it. It also prevents GTN from giving preferential treatment to a customer that wishes to enter a prearranged deal without first subjecting the deal to a bidding process, and prevents GTN from achieving a better deal in the future than it may negotiate today. Since the GTN proposal allowed GTN to enter prearranged deals at its discretion, the new conditions ensure that GTN will deny interim shippers a right of first refusal only after awarding the future capacity to a shipper that values it most. And it gives generation developers the opportunity to secure capacity in advance, without the risk that it will later have to match a competing bid for the capacity during a subsequent bidding process.

The Commission orders:

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[15] The other conditions previously ordered by the Commission – (1) posting required before GTN enters into a prearranged deal and (2) no five-year minimum contract term – will continue to apply. To some extent, the net present value bidding process for prearranged deals also will address these concerns.

(A) GTN's proposed waiver of the right of the first refusal is granted, subject to the conditions specified in this order.

(B) GTN must submit a compliance filing consistent with this order within 30 days.

By the Commission.

(S E A L)

Linda Mitry,
Deputy Secretary.