

Securing New Pipeline Capacity in Today's Turbulent Gas Market: Best Practices and Things to Know

By **Barbara S. Jost and Glenn S. Benson, Partners at Davis Wright Tremaine LLP**

The new and prolific gas supply sources made possible by the combination of hydraulic fracturing technology and horizontal drilling have upended traditional supply and demand markets throughout the country. They have led to numerous pipeline expansion projects to add new pipelines, reverse flows or provide for bi-directionality, and otherwise modify their existing systems to attract these new supplies and serve existing and new markets. Shippers seeking access to supplies and/or markets are frequently confronted with competing pipeline project options. As part of the process of evaluating expansion options, shippers will need to familiarize themselves with the Federal Energy Regulatory Commission (FERC or Commission) rules governing the sale of pipeline expansion capacity. This article combines a discussion of FERC precedent with some practice pointers. It begins with an explanation of the Open Season process for sales of expansion capacity, then addresses issues encountered in the negotiation of precedent agreements (PAs) with pipelines, and concludes with a discussion of non-conforming transportation service agreements (TSAs).

I. Pipeline Open Seasons

a. The Legal Framework

Under section 1(b) of the Natural Gas Act (NGA), the FERC has jurisdiction over the transportation of natural gas in interstate commerce and over the natural gas companies that provide this transportation.¹ Under section 7(c) of the NGA, no natural gas company may transport natural gas or construct any facilities used for such transportation without first receiving a certificate of public convenience and necessity issued by the Commission.²

In determining whether a proposed project is in the public convenience and necessity, the Commission starts with its Certificate Policy Statement³ guidelines, which set forth an analytical framework under which the Commission determines whether there is a need for a proposed expansion and whether it will serve the public interest. The Commission performs a “flexible balancing process” where it weighs and considers the factors presented in an application such as the proposal’s market support, economic, operational and competitive benefits and its environmental impact.⁴

¹ 15 U.S.C. § 717.

² 15 U.S.C. § 717f.

³ *Certification of New Interstate Natural Gas Pipeline Facilities*, 88 F.E.R.C. ¶ 61,227 (1999), *order on clarification*, 90 F.E.R.C. ¶ 61,128 (2000), *order on clarification*, 92 F.E.R.C. ¶ 61,094 (2000) [hereinafter Certificate Policy Statement].

⁴ Certificate Policy Statement, 88 F.E.R.C. ¶ 61,227, at p. 61,743.

For expansion projects, the Certificate Policy Statement sets as a threshold requirement that the pipeline be prepared to financially support the project without relying on subsidization from its existing customers.⁵ The pipeline must also demonstrate that it has made efforts to eliminate or minimize any adverse effects the project might have on its existing customers, existing pipelines in the market and their captive customers, and landowners and communities to be affected by the construction. If residual adverse effects on these groups remain, the Commission will perform an economic balancing test comparing the public benefits to be achieved by the expansion against the residual adverse effects. If the proposal passes muster under this test, FERC will proceed with an environmental analysis of the project.

These policies regarding expansion capacity should be contrasted with the streamlined open access rules governing pipeline sales of existing capacity, first promulgated under Order No. 636, which generally require that existing capacity be made available on a first-come, first-served basis and then later added the option to allow bidding on a net present value (NPV) basis.⁶

Since 1995, with the issuance of the Commission's Pricing Policy Statement,⁷ pipelines have been required to solicit capacity turn-backs in conjunction with any proposed expansion to determine whether there are any shippers that would be willing to permanently relinquish capacity and thereby reduce the size of any needed expansion.⁸ This policy statement also provided industry guidance on how, going forward, pipelines could recover the costs of new construction. Under the Pricing Policy Statement, determinations regarding the appropriate rate design for recovery of new construction costs were to be made in the pipeline's certificate proceeding and pipeline requests for rolled-in pricing of such costs were to be evaluated by comparing the system benefits of the expansion with the rate impacts of the expansion on the pipeline's existing customers. The Pricing Policy Statement established a presumption in favor of rolled-in pricing for expansion costs where the Commission could determine that the rate effect on existing customers would not be substantial.⁹ Pipeline solicitation of turn-back capacity was an essential prerequisite to this determination, the Commission found, because if

⁵ This threshold requirement applies equally to pipeline proposals to lease capacity on existing facilities. *See, e.g., Texas Eastern Transmission, L.P.*, 139 F.E.R.C. ¶ 61,138 at P 16, n.11 (2012).

⁶ *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation; and Regulation of Natural Gas Pipelines After Wellhead Decontrol*, Order No. 636, F.E.R.C. STATS. & REGS. ¶ 30,939 at 30,428–29 (1992), *order on reh'g*, Order No. 636-A, F.E.R.C. STATS. & REGS. ¶ 30,950, *order on reh'g*, Order No. 636-B, 61 F.E.R.C. ¶ 61,272, 57 Fed. Reg. 57,911 (1992), *order on reh'g*, 62 F.E.R.C. ¶ 61,007 (1993), *aff'd in part and remanded in part sub nom. United Distribution Cos. v. FERC*, 88 F.3d 1105 (D.C. Cir. 1996), *order on remand*, Order No. 636-C, 78 F.E.R.C. ¶ 61,186 (1997) (codified at 18 C.F.R. pt. 284) [hereinafter Order No. 636].

⁷ *Pricing Policy for New and Existing Facilities Constructed by Interstate Natural Gas Pipelines*, 71 F.E.R.C. ¶ 61,241 (1995) [hereinafter Pricing Policy Statement].

⁸ *See, e.g., Mojave Pipeline Co.*, 73 F.E.R.C. ¶ 61,300, at p. 61,838 (1995). Pipelines are only required to consider and evaluate offers of turnback capacity which are similar to the proposed expansion in terms of location, term, and price. *See Cheyenne Plains Gas Pipeline Co., L.L.C.*, 121 F.E.R.C. ¶ 61,273 at P 36 (2007) (*citing PG&E Gas Transmission*, 84 F.E.R.C. ¶ 61,204, at p. 62,001 (1998)).

⁹ Pricing Policy Statement, 71 F.E.R.C., at p. 61,915.

turn-back capacity was available, it would serve to reduce project costs and thereby moderate the potential rate impacts on existing customers associated with the roll-in.¹⁰

The presumption in favor of rolled-in pricing for expansion costs, however, was reversed by the Commission five years later in its Certificate Policy Statement based on the determination that a policy favoring the incremental pricing of such costs sends the proper price signals to the market and provides an incentive for the optimal level of pipeline construction.¹¹ This switch did not impact the process otherwise. Pipelines are still required to conduct open seasons to solicit turn-back capacity before proposing any expansion.¹² However, whether and to what extent capacity turn-back offers are accepted by the pipeline and included in a proposed expansion is a matter which has been generally left to the pipeline's discretion. This deference is consistent with "Commission precedent, which demonstrates reluctance on the Commission's part to substitute its own judgment for pipeline companies' own business decisions on whether particular project alternatives would be cost-effective and timely options."¹³

Since 1991,¹⁴ the Commission also has required that new interstate pipeline construction projects "be preceded by a fair open season process through which potential shippers may seek and obtain firm capacity rights."¹⁵ This open season process is intended to provide market transparency and ensures that any new capacity is allocated in a not unduly discriminatory manner.¹⁶

b. Open Season Specifics

Before filing for construction authorization under the NGA, pipelines are today required to conduct two forms of open seasons. First, they must conduct a reverse open season (also known as a turn-back open season) in which existing customers are given an opportunity to permanently relinquish their capacity (so that the pipeline can later account in its certificate application for how offers it received to permanently release capacity, if any, impacted the size

¹⁰ *Id.* at 61,917.

¹¹ Certificate Policy Statement, 88 F.E.R.C. ¶ 61,227, at p. 61,915. However, the Commission still grants pipeline requests for predetermination of rolled-in pricing treatment for expansions upon a showing that the existing shippers are not subsidizing the expansion. *See Wyoming Interstate Ltd.*, 130 F.E.R.C. ¶ 61,251 (2010). The Commission has also issued a pre-determination approving rolled-in expansion base rates while requiring expansion fuel to be priced incrementally. *See ANR Pipeline Co.*, 149 F.E.R.C. ¶ 61,197 at PP 23–25 (2014). Conversely, the Commission has approved incremental reservation rates for service on an expansion but required the use of existing system fuel rates when the expansion shippers have the ability to transport on the pre-existing system. *Paiute Pipeline Co.*, 153 F.E.R.C. ¶ 61,292 at P 17 (2015).

¹² *See e.g., Northern Border Pipeline Co.*, 90 F.E.R.C. ¶ 61,263, at p. 61,879 (2000).

¹³ *Texas Eastern Transmission, L.P.*, 146 F.E.R.C. ¶ 61,086 at P 41 (2014) (footnote omitted).

¹⁴ *Revisions to Regulations Governing Authorizations for Construction of Natural Gas Pipeline Facilities*, Order No. 555, F.E.R.C. STATS. & REGS. ¶ 30,928 (1991) (codified at 18 C.F.R. pts. 2, 154, 157, 284, 375, and 380).

¹⁵ *Pine Prairie Energy Ctr., L.L.C.*, 135 F.E.R.C. ¶ 61,168 at P 30 (2011) (*citing Algonquin Gas Transmission, L.L.C.*, 120 F.E.R.C. ¶ 61,072 at P 58 (2007)); *Gulf South Pipeline Co.*, 95 F.E.R.C. ¶ 61,132, at p. 61,415 (2001).

¹⁶ *Pine Prairie Energy Ctr., L.L.C.*, 135 F.E.R.C. ¶ 61,168 at P 30; *Gulf South Pipeline Co.*, 95 F.E.R.C. ¶ 61,132, at p. 61,415.

of the proposed expansion).¹⁷ While the Commission has not established a specific timeframe for when such a reverse open season must take place, it has found a reverse open season compliant when conducted within 90 days after the conclusion of a posting for an expansion open season.¹⁸ Second, either as part of this same capacity turn-back open season, or separately, pipelines must post a notice of open season describing the expansion capacity available for bid. Such notice is to be set forth in a non-discriminatory method of allocating the to-be-available expansion capacity should it be oversubscribed by qualified bidders.

Pipelines also must provide an open season notice on their electronic bulletin boards when they wish to reserve from sale, any existing unsubscribed capacity and/or capacity under expiring contracts without a right of first refusal (ROFR) or an “evergreen” right. Such reservations are made by pipelines where the capacity is to be utilized for a planned expansion project. The required open season notice must give shippers an opportunity to bid for this existing capacity before the pipeline reservation takes place. If no bids occur, the reservation can remain in place for a twelve-month period prior to the pipeline filing for certificate approval for construction of the proposed expansion.¹⁹ The terms and conditions of such a pre-reservation open season and the subsequent expansion open season must be the same.²⁰

The capacity subject to this reservation could still be sold on an interim basis; however, the shipper purchasing the interim capacity would not have any associated ROFR right, thus assuring the availability of the capacity for the expansion.

Pipelines can construct smaller expansions under their blanket certificate authority without first conducting an open season.²¹ However, the Commission allows pipelines the discretion to conduct an open season even if the construction can be done under its blanket authority where the pipeline wants to also reserve existing capacity as part of the new project.²²

An expansion open season notice provides prospective shippers with a basic idea as to how the auction for capacity will be conducted. Discussions with pipeline personnel to explain

¹⁷ As noted previously, pipelines have substantial discretion in how they handle capacity turn-back offers. *See Texas Eastern*, 146 F.E.R.C. ¶ 61,086 at PP 41–42. Pipelines do not have to accept offers of turn back capacity that would result in an economic loss for the pipeline. *See Cheyenne Plains*, 121 F.E.R.C. ¶ 61,273 at P 35. However, where a pipeline conducted a turn-back open season to support a future abandonment application without disclosing this planned future abandonment in its turn-back open season notice, the pipeline was required to conduct a supplemental turn-back open season. *Trunkline Gas Co., L.L.C.*, 145 F.E.R.C. ¶ 61,108 at P 20 (2013).

¹⁸ *Tennessee Gas Pipeline Co.*, 86 F.E.R.C. ¶ 61,066, at p. 61,259 (1999).

¹⁹ *See Midwestern Gas Transmission Co.*, 106 F.E.R.C. ¶ 61,229 at P 8 (2004); *Columbia Gulf Transmission Co.*, 100 F.E.R.C. ¶ 61,133 (2002); *Texas Eastern Transmission Corp.*, 80 F.E.R.C. ¶ 61,270, at pp. 61,980–61,981 (1997); *Tennessee Gas Pipeline Co.*, 82 F.E.R.C. ¶ 61,288 (1999). Where a showing of need is made, the Commission has allowed an 18-month capacity reservation in connection with an expansion. *See Cameron LNG, L.L.C. and Cameron Interstate Pipeline, L.L.C.*, 147 F.E.R.C. ¶ 61,230 at P 50 (2014).

²⁰ *Texas Gas Transmission, L.L.C.*, 111 F.E.R.C. ¶ 61,480 at P 6 (2005).

²¹ Under blanket certificate authority, pipelines are allowed to construct, acquire, operate, replace and rearrange “eligible facilities” up to certain annual dollar limits without any further authorization from the Commission. *See* 18 C.F.R. §§ 157.202; 157.208(d); 284.11; 284.221(f)(3) (2015).

²² *Questar Pipeline Co.*, 152 F.E.R.C. ¶ 61,168 at P 7 (2015).

open season bid requirements are permitted, and depending on the number and substance of the questions asked, a pipeline may conduct a supplemental open season to clarify bid terms.²³

Pipelines have wide discretion in how they actually conduct such open seasons. Pipelines may initially solicit interest via a “non-binding” open season and then follow with a “binding” open-season, only post a single notice of open season, or hold one or more supplemental open seasons, depending on market demand.²⁴ The amount of time allowed to respond to the notice of open season can vary dramatically, with longer periods typically given where there is still a strong need for the pipeline to solicit customer interest and shorter periods where the pipeline has already negotiated precedent agreements with potential “anchor” shippers for most or all of the capacity to be added.

Where a project has one or more anchor shippers who have entered into binding capacity commitments before the open season posting, the open season notice typically will acknowledge that there are anchor shipper agreements, describe these agreements (including the amount of capacity committed, the rate and the term agreed-to) and state that such anchor shipper agreements are deemed binding qualifying bids for purposes of the subsequent open season. The open season notice will specify the minimum capacity, rate and term for any new qualifying bids. With respect to the rate, the notice may specify a stated negotiated and/or discounted rate but it will also allow the bidder the option to offer to pay the maximum applicable cost of service recourse rate.²⁵ The notice will also specify any other terms required for a bid to be deemed qualifying, including the requirement that the bidder agree to execute a precedent agreement by a

²³ See *Paiute Pipeline*, 151 F.E.R.C. ¶ 61,132 at P 7.

²⁴ See *Algonquin Gas Transmission, L.L.C.*, 150 F.E.R.C. ¶ 61,163 P 7 (2015); *Texas Eastern Transmission, L.P.*, 149 F.E.R.C. ¶ 61,259 at P 6 (2014); *Transcontinental Gas Pipe Line Co., L.L.C.*, 145 F.E.R.C. ¶ 61,152 at P 5 (2013). And market demand for an expansion may change. For example, after having received confidential expressions of interest for 100% of a proposed expansion in a non-binding open season, the pipeline later reported that it entered into precedent agreements with shippers for 62% of the available expansion capacity. See *Cameron LNG*, 147 F.E.R.C. ¶ 61,230 at P 36. Where a shipper declines to execute a precedent agreement after successfully bidding for capacity, the pipeline may decide to hold an additional open season. See *Paiute Pipeline Co.*, 132 F.E.R.C. ¶ 61,156 at P 4 (2010).

²⁵ In its *Alternative Rate Policy Statement*, the Commission announced that pipelines and shippers may negotiate rates that vary from the otherwise applicable tariffs, as long as the pipelines continue to alternatively offer a recourse rate for those shippers preferring traditional cost-of-service rates. *Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines and Regulation of Negotiated Transportation Service for Natural Gas Pipelines*, 74 F.E.R.C. ¶ 61,076, at p. 61,241 (1996), *reh'g and clarification denied*, 75 F.E.R.C. ¶ 61,024 (1996), *reh'g denied*, 75 F.E.R.C. ¶ 61,066 (1996), *petition for review denied*, *Burlington Resources Oil & Gas Co. v. FERC*, Nos. 96-1160, *et al.*, U.S. App. Lexis 20697 (D.C. Cir. 1998) [hereinafter *Alternative Rate Policy Statement*]. Where a pipeline solicits negotiated rate bids in its open season notice but fails to offer bidders a recourse rate alternative, the Commission has held the open season invalid and ordered the pipeline to conduct a new open season. See *Natural Gas Pipeline Co. of America*, 101 F.E.R.C. ¶ 61,125 at P 39 (2002). Where the expansion is to a new currently unserved area, such recourse rates are typically incremental rates derived solely from the cost of service associated with the new facilities. See *Cameron LNG*, 147 F.E.R.C. ¶ 61,230 at P 41. Where an expansion is integrated with and operated as part of the pipeline’s existing system, the Commission has disallowed proposals to charge existing customers an access charge to use such expansion capacity. See *e.g., Equitrans, L.P.*, 136 F.E.R.C. ¶ 61,046 at P 22 (2011). However, where an expansion is both within the existing service territory and also extends to new previously unserved areas beyond, the Commission has allowed pipelines to recover additional costs from existing shippers seeking to use the expansion facilities. See *Texas Eastern Transmission*, 139 F.E.R.C. ¶ 61,138 at P 38.

date certain. It will explain how the pipeline will evaluate all qualifying bids received and how it will allocate available capacity to the extent the capacity associated with all such qualifying bids exceeds the available expansion capacity.²⁶ As a related matter, the notice will ask the prospective bidder to specify in its bid whether it has a minimum contract quantity requirement below which it does not desire any capacity to be awarded or whether it will take any amount awarded as a result of the allocation process. The notice will also ask the bidder to specify any contingencies it places on its bid, such as the need for Board of Directors' approval or state regulatory approval.

In 2011, the Commission revised its rules to prohibit multiple affiliates of the same entity from bidding in an open season for pipeline capacity in which the pipeline may allocate the capacity awarded on a *pro rata* basis, unless each affiliate has an independent business reason for submitting a bid.²⁷ Since then, open season notices frequently require that bidders certify their compliance with this rule in their bids.

There can be a multi-year delay between an expansion open season and the actual filing of the certificate application if the pipeline decides to modify its proposed project to engender additional customer support or if market circumstances change.²⁸ More commonly, however, the certificate application is filed shortly after, or within a year of, the end of the open season.²⁹

The actual award of expansion capacity is governed in part by the economic criteria set forth in the open season notice, which criteria usually relies on the pipeline's calculation of the NPV of each bid. If the notice so states, a pipeline may aggregate bids for capacity so as to generate the highest NPV to the pipeline.³⁰ In evaluating bids, pipelines may also need to take into account operational factors such as constraints based on the volumes and receipt and delivery point combinations requested. The Commission's primary interest is insuring that the open season process is conducted fairly. It has demonstrated a strong reluctance to disturb pipeline capacity awards retroactively.³¹

II. Precedent Agreements

²⁶ See e.g., *Columbia Gas Transmission, L.L.C.*, 146 F.E.R.C. ¶ 61,075 at P11 (2014) (awarding both successful bidders 50% of the available capacity where both had bid for 100% of the available capacity).

²⁷ *Bidding by Affiliates in Open Seasons for Pipeline Capacity*, Order 894, 137 F.E.R.C. ¶ 61,126 (2011) (codified at 18 C.F.R. pt. 284).

²⁸ See, e.g., *Dominion Transmission, Inc.*, 141 F.E.R.C. ¶ 61,240 at P 10 & n.8 (2012) (open season held in 2007 resulting in a 2012 expansion project filing).

²⁹ See e.g., *Sierrita Gas Pipeline, L.L.C.*, 147 F.E.R.C. ¶ 61,192 at P 9 (2014) (open season completed less than one month before filing).

³⁰ *Texican N. La. Transport, L.L.C. v. Southern Natural Gas Co.*, 132 F.E.R.C. ¶ 61,167 at P 23 (2010). The Commission views this preference for awarding capacity to those bids that generate the highest NPV as entirely consistent with its existing policy of encouraging bids that award the pipeline the greatest economic benefit, and "by extension benefits all customers, including existing customers." *Id.* at P 26 (citing *Tennessee Gas Pipeline Co.*, 94 F.E.R.C. ¶ 61,097, at pp. 61,402–61,403 (2001)).

³¹ See *id.* at P 51 (citing at n. 47 earlier cases where the Commission has not exercised its remedial authority to overturn awards of capacity).

If one is a successful bidder in an open season for expansion capacity, the next task is negotiating a precedent agreement (PA) with the pipeline. The PA sets forth the commercial terms under which the pipeline proposes to build the project, the financial terms under which the shipper is to purchase the expansion capacity and the specific amount, transportation path, and terms of service to be provided. The following are some of the key issues typically encountered in a PA negotiation.

a. Tying Down the Service Commencement Date.

A shipper negotiating an expansion PA will desire some degree of certainty as to when the expansion capacity will be placed in service. Shippers will therefore seek to include PA language addressing not just the target service commencement date but also what will happen if the project falls behind schedule or fails to achieve the target in-service date. To manage the economic risk of delays, shippers may seek off-ramp provisions in the PA that allow them to terminate if the project fails to stay on track or is not placed in service within a specified amount of time after the target commencement date. While it is understandable that pipelines require some ability to deviate from the target in-service date, given the multitude of issues that can impact a project's completion, pipelines routinely agree to terms and conditions that balance their interest in having a degree of flexibility with the shipper's need to have service commence by a date reasonably proximate to the target service commencement date.

For example, shippers may seek a contractual right to terminate the PA if the pipeline:

- (1) fails to order the pipe and/or steel required for the project by a specified date;
- (2) fails to file its application for a FERC certificate within a specified number of months of the date the PA is executed;
- (3) fails to receive a FERC certificate within a specified amount of time; or
- (4) is not ready to commence service within a specified amount of time after the target service commencement date.

Where market conditions provide the shipper with leverage in negotiations, pipelines sometimes also agree that, in the event of a service commencement delay of a specified length, the shipper will receive a discount of some specified amount for a stated term (*e.g.*, a one-year delay in service commencement will entitle the shipper to its first year of service at a discounted rate).

PAs sometimes provide for the possibility of interim service in the event the project is completed ahead of schedule or is only partially completed on the proposed service commencement date. Issues to consider in negotiating for interim service include identifying the rate and terms that would apply during the interim term, and the effects, if any, that such interim service would have on the primary service that is the subject of the PA (*e.g.*, whether the primary term would be static, or whether it would be reduced by the length of any prior interim service term).

b. Rates

Shippers negotiating a PA are frequently presented with the option to take service at a negotiated rate. A negotiated rate could, for example, take the form of a fixed rate, a fixed rate that is adjusted annually or seasonally, a formula rate, a levelized rate, a rate that is adjusted based on the ultimate project cost, a rate that will be discounted in the event the pipeline is able to secure additional commitments during a specified period of time, or a rate in which some fixed costs are assigned to the commodity component of the rate. A negotiated rate also may provide for a sharing of revenues received by the pipeline from interruptible or short-term firm transportation service. Under FERC policy, however, the shipper in a PA negotiation should always have the option of electing service at the pipeline's maximum recourse rate instead.³²

At the time of the PA negotiation, the rate paid by a negotiated rate shipper may be higher or lower than the otherwise applicable (or projected) recourse rate, and a negotiated rate that is lower than the recourse rate today may not be so tomorrow. Recourse rates commonly (though not always) decline over time, as the pipeline's rate base becomes more fully depreciated. Therefore, a shipper considering a fixed negotiated rate for a long-term contract that provides a small discount from the pipeline's expected initial recourse rate should recognize there is some possibility that they would be paying a higher rate than recourse rate shippers in later years of the service term. This would not be an issue under a discounted rate contract, since the rate, by definition, could not exceed the maximum recourse rate.

When negotiating the terms of a negotiated rate in the PA, the shipper should consider seeking to have the negotiated rate apply not just to the shipper's primary receipt and delivery points, but also to any secondary "in-path" receipt and delivery points that might be used. If the fuel charge is to be incrementally priced, the shipper may wish to seek PA language providing that, in the event of any future expansion in which the pipeline proposes to roll-in the fuel associated with the expansion capacity into the base fuel rate, the shipper's negotiated rate will be reduced by the value of any difference between the then baseline fuel rate and the filed expansion fuel rate.

c. Termination Due to Failure of Conditions Precedent

All PAs contain "conditions precedent" that allow for subsequent termination of the PA by one or both parties if assumed future events (*e.g.*, issuance of FERC certificate of public convenience and necessity by a specified date), do not occur or the condition is not waived. In some instances, however, the terminating shipper will have certain financial obligations to the pipeline (see discussion of pre-service costs, *infra*).

It should be noted that conditions precedent do not themselves normally obligate a party to take any action. Any obligations the shipper wants the pipeline to have should be stated separately elsewhere in the PA. For example, the shipper may want to require the pipeline to provide it with written notice of when the pipeline has received certain permits and authorizations, so that the shipper can verify whether a particular condition precedent has been met.

³² *Alternative Rate Policy Statement*, 74 F.E.R.C. ¶ 61,076, at p. 61,241.

Typical conditions precedent sought by the pipeline include:

- (1) Where the signature of the shipper's authorized representative is not sufficient to bind the shipper, a requirement that the shipper's Board of Directors or Management Committee (or similar governing body) approves the PA by a specified date usually corresponding to its next meeting. Such a condition can benefit both parties by allowing timely execution of the PA.
- (2) The pipeline securing a threshold level of capacity commitments through executed PAs. This enables the pipeline to walk away from a project where it fails to obtain sufficient capacity commitments to make the project economic or financeable. While such "market out" clauses are not uncommon, the shipper may seek reciprocal language providing that the deadline for executing such other PAs be fairly tight to ensure the shipper is not locked into a one-way commitment for an amount of time that is commercially unreasonable. The shipper may also wish to eliminate any proposed language giving the pipeline "sole discretion" as to whether it has secured adequate PAs and replace it with language obligating the pipeline to go ahead with the project if a specific aggregate maximum daily quantity is subscribed by a specified deadline.
- (3) The shipper's maintenance of creditworthiness or alternative credit support in accordance with the creditworthiness provisions of the PA. This allows the pipeline to terminate the PA if the shipper fails to maintain creditworthiness or adequate credit support, an issue that is always important but of greater prominence today as oil and gas prices continue to decline. The amount of credit support required for an expansion shipper deemed not creditworthy is governed by the terms of the PA and not the pipeline's tariff. In other words, FERC policies that cap the amount of credit support pipelines can require of shippers using existing capacity do not apply to PAs for expansion capacity.
- (4) The pipeline obtaining, by a specified date, a certificate of public convenience and necessity from FERC that contains all the necessary FERC authorizations for the project and is satisfactory in form and substance to the pipeline. Pipelines need to retain the ability to decline to move ahead on the project if FERC's certificate contains material terms or conditions that undermine the project economics. However, the shipper may wish to ensure that the condition precedent is not so broadly worded as to allow the pipeline to use the certificate order as a pretext for terminating the PA for other reasons. For example, a shipper might insist on language providing that the certificate order shall be deemed satisfactory in form and substance to the pipeline unless it imposes terms and conditions that substantially and materially degrade the project's economics or impose commercially unreasonable risks on the pipeline.
- (5) Pipeline's receipt of all additional governmental authorizations, approvals, and permits by a specified date. Pipelines often seek the right to terminate if they encounter lengthy delays in obtaining regulatory authorizations generally. If presented with such a proposed condition precedent, the shipper may wish to

ascertain the reasonableness of the deadline the pipeline proposes and ensure that the pipeline has assumed reasonable due diligence obligations associated with such authorizations.

- (6) Pipeline's ability to obtain necessary rights-of-way easements by a specified date. If presented with such a proposed condition precedent, shippers may wish to object since FERC certificates are issued under the NGA and accord pipelines the right to exercise eminent domain.³³
- (7) Pipeline's receipt by a specified date of approval from its Board of Directors, Management Committee (or similar governing body) to expend the capital necessary to construct the project. Depending on market conditions, shippers may wish to resist inclusion of such a condition precedent, as it effectively gives the pipeline the right to pull the plug on the project for no reason (often at a fairly late stage), leaving a shipper with much less attractive alternatives. Alternatively, the shipper may seek to move the deadline to as early a date as possible and propose PA language limiting the pipeline management's discretion to walk away from the project to situations where factors outside the pipeline's control have rendered the project no longer financially viable.
- (8) Although many expansions are financed by internally generated funds, where a pipeline is planning to rely on outside financing, it may seek to condition the PA on its receipt of financing on acceptable terms by a specified date. In response, a shipper could propose PA language that specifies financing terms that shall be deemed acceptable to the pipeline (*e.g.*, a term of x years at a fixed interest rate of y%, payable quarterly). It also may behoove the shipper to condition invocation of the condition precedent on the pipeline having sought financing from a specified minimum number of financial institutions and begun the process by a specified deadline.

Typical conditions precedent that a shipper may request include:

- (1) For shippers that are local distribution companies (LDCs), the LDC's receipt of state commission authorization for pass-through of costs, and other authorizations, as required.
- (2) Pipeline's receipt of all FERC certificates and authorizations by a date certain. This gives the shipper the ability to terminate the agreement if the FERC certificate process proves significantly more protracted than anticipated. All expansion shippers have gas supply/demand risks to manage and need the ability to sign onto another project or procure other capacity and/or supply/delivery rights to manage those risks.
- (3) The FERC certificate order does not contain conditions that have a material adverse effect on shipper, such as, for example, a condition requiring material changes to the PA itself; a modification to the pipeline route, capacity, or receipt/delivery points; or

³³ 15 U.S.C. § 717f(h).

a change in the pipeline's generally applicable rates, terms or conditions that adversely impact the shipper.

- (4) Completion of associated upstream/downstream transportation facilities required to effectuate the service contemplated under the PA. Where shipper's ability to use the expansion capacity is subject to the completion of such other upstream and/or downstream projects, the shipper may wish to insist on having a condition precedent allowing it to terminate if such upstream and/or downstream projects are not completed, or have not reached specified milestones, by a specified date.

d. Additional Termination Rights

In addition to having termination rights in the event the PA's conditions precedent are not satisfied or waived, shippers typically seek a right to terminate if the pipeline fails to commence service by a particular date. However, the pipeline may seek to limit this right to provide that it can only be exercised in the event the delay is not attributable to *force majeure*.

e. Anchor shipper status; open season successful bidder status, preferential terms and conditions and/or rates

Pipelines are required to file any service agreement containing non-conforming provisions and to disclose and identify any transportation term or agreement in a precedent agreement that survives the execution of the service agreement.³⁴ Although Section 4 of the NGA prohibits pipelines from offering *unduly* discriminatory rates, terms, or conditions of service, pipelines are permitted to engage in *due* discrimination. In the context of a pipeline expansion project, this means that pipelines can offer certain terms and conditions to so-called foundation or anchor shippers that are not offered to others, provided certain conditions are met. For some pipeline projects, there may be only one category of anchor shippers, such as those shippers submitting a qualifying bid in the open season and timely executing a PA. For other projects, there have been two special categories.³⁵ And for others, there are no special categories.

FERC permits pipelines to offer special terms to such shippers on grounds that their PAs provide the needed market support to ensure that the project may actually be built.³⁶

³⁴ 18 C.F.R. § 154.112(b) (2015). What is a permitted or disallowed non-conforming provision in a TSA is addressed *infra* in Section III.

³⁵ See *ETC Tiger Pipeline, L.L.C.*, 131 F.E.R.C. ¶ 61,010 at P 6, n. 2 (2010) (according foundation shipper status to those making capacity commitments equal to 900,000 Dth/d or more for a primary term of at least 15 years, while Anchor Shipper status accorded to those capacity commitments equal to 300,000 Dth/d or more for a primary term of at least 10 years); *Rockies Express Pipeline L.L.C.*, 116 F.E.R.C. ¶ 61,272 at PP 23–24 (2006) (foundation shippers include shippers executing precedent agreements for long-term capacity commitments to REX-West and REX-East equal to, or exceeding, 500,000 Dth/day, while Anchor Shippers consist of shippers making long-term capacity commitments to both REX-West and REX-East by executing precedent agreements for firm transportation equal to or exceeding 200,000 Dth/day, but less than 500,000 Dth/day); *Ruby Pipeline, L.L.C.*, 128 F.E.R.C. ¶ 61,224 (2009) (anchor shipper contracted for greater quantity (375,000 Dth/day) and a longer term (15 years)).

³⁶ *ETC Tiger Pipeline*, 131 F.E.R.C. ¶ 61,010 at P 77; see also, e.g., *Rockies Express*, 116 F.E.R.C. ¶ 61,272 at P 78.

Since PAs are not part of a pipeline’s tariff and thereby subject to regulation under NGA Section 4, FERC is not typically asked to address the reasonableness of PA terms. Rather the FERC addresses the reasonableness of expansion terms and conditions when they are incorporated in the TSA, a topic discussed *infra* at Section III. However, when asked to evaluate PA provisions, the FERC distinguishes between certain special pre-service or rate-related terms that do not give the anchor shipper a higher quality of service after the project goes into service (which are permissible) and special terms and conditions of service (which generally are not).³⁷ Under the first category, for example, the Commission has approved of non-conforming provisions that:

- Give the shipper a right to select its MDQ as late as six months prior to the in-service date;³⁸
- Coordinate the first day of the TSA with the in-service date of the expansion to accommodate the shipper (*e.g.*, provisions requiring that service commence on the first day of the first calendar month after the project is placed in service);³⁹ and
- Require the shipper to begin paying transportation charges on the actual in-service date regardless of whether the shipper begins taking service then.⁴⁰

For special terms and conditions of service to be permissible, they must be offered to all shippers who submit bids in the open season that qualify for the same foundation/anchor shipper status.⁴¹ For example, a pipeline might state in its open season notice that “[a]nchor shippers will enjoy benefits such as contract extension rights and other benefits negotiated on a not unduly discriminatory basis.” If the pipeline then offers each anchor shipper a one-year extension right, there is no undue discrimination because all shippers were given the opportunity to become anchor shippers as part of the open season and receive this benefit.⁴²

A pipeline cannot, however, offer anchor shippers special “terms of service” that are not specifically identified in the open season notice. Thus, an open season notice’s reference to “other benefits negotiated on a not unduly discriminatory basis” has been found by FERC to be too vague, providing inadequate public notice of other benefits the pipeline might wish to accord anchor shippers, such as rights to ramp-up and/or ramp-down their MDQs.⁴³ Rate incentives in

³⁷ See *Columbia Gas Transmission, L.L.C.*, 153 F.E.R.C. ¶ 61,008 at PP 7–21 (2015).

³⁸ *Id.* at P 9.

³⁹ *Id.* at P 10.

⁴⁰ *Id.* at P 11.

⁴¹ See *Columbia Gas Transmission, L.L.C.*, 149 F.E.R.C. ¶ 61,146 at P 36 (2014).

⁴² *Columbia Gas Transmission, LLC*, 153 F.E.R.C. ¶ 61,146 at P 9 (2015).

⁴³ *Columbia Gas Transmission*, 153 F.E.R.C. ¶ 61,008 at P 18–20.

PAs, must be “clearly defined in the announcement of the open season, publicly verifiable, and equally available to all potential shippers.”⁴⁴

Under this standard, a wide array of anchor shipper provisions have been found by FERC to be permissible or potentially permissible in a PA, if properly disclosed in the open season notice, including:

- (1) Special rates for anchor shippers;⁴⁵
- (2) most favored nations rate treatment;⁴⁶
- (3) annual contract rollover rights;⁴⁷
- (4) a one-time contractual ROFR;⁴⁸
- (5) one-year term extension right;⁴⁹
- (6) a one-time unilateral right to extend the term of its agreement;⁵⁰
- (7) permitting the anchor shipper to shift its primary receipt or delivery points;⁵¹
- (8) permitting the anchor shipper to increase and decrease its contract demand.⁵²
- (9) granting the anchor/foundation shippers a cap on the fuel and lost and unaccounted for gas that may be recovered from them;⁵³
- (10) granting shipper the right to acquire available unsubscribed firm capacity on the pipeline’s system, except for capacity created through any expansion thereof, at the negotiated rates provided for in such agreement, provided that the actual award of such capacity will be subject to competitive bidding;⁵⁴

⁴⁴ *Ruby Pipeline*, 128 F.E.R.C. ¶ 61,224 at P 49.

⁴⁵ *Rockies Express Pipeline L.L.C.*, 150 F.E.R.C. ¶ 61,161 at PP 21–24 (2015).

⁴⁶ *Ruby Pipeline*, 128 F.E.R.C. ¶ 61,224 at P 46; *Rockies Express Pipeline L.L.C.*, 116 F.E.R.C. ¶ 61,272 at PP 22-24, 72-73 (2006).

⁴⁷ *Rockies Express*, 150 F.E.R.C. ¶ 61,161 at P 23.

⁴⁸ *Ruby Pipeline*, 128 F.E.R.C. ¶ 61,224 at P 78; *Rockies Express*, 116 F.E.R.C. ¶ 61,272 at PP 23-24, 72-73.

⁴⁹ *Ruby Pipeline*, 128 F.E.R.C. ¶ 61,224 at 77.

⁵⁰ *Columbia Gas Transmission*, 153 F.E.R.C. ¶ 61,008 at P 14; *Columbia Gas Transmission*, 153 F.E.R.C. ¶ 61,146 at P 9.

⁵¹ *Columbia Gas Transmission*, 149 F.E.R.C. ¶ 61,146 at PP 32, 36.

⁵² *Id.* at PP 34, 36.

⁵³ *ETC Tiger Pipeline*, 131 F.E.R.C. ¶ 61,010 at PP 72, 77.

⁵⁴ *Id.* at P 73, 77.

(11) granting shipper a one-time right to cause the pipeline to increase its design capacity up to a specified amount, provided that the pipeline afford other shippers an opportunity to bid for and obtain such additional capacity in a non-discriminatory manner through an open season process.⁵⁵

f. Project Scope

The PA should define the project consistent with how the project was defined in the Open Season notice(s). This is important for several reasons.

First, having a clear understanding as to the project's scope is essential to ensuring there are no hidden costs. Where the shipper is going to be relying on new or expanded receipt and/or delivery points or interconnections, the PA needs to specifically address the construction or expansion of such points, including the installation of any associated taps, metering and regulation stations, and compression. If any of these are excluded from the project definition, the shipper may be required to bear the cost of such facilities in addition to the PA-specified transportation charges.

Second, the future market value of the shipper's capacity—not just to the shipper but also in the secondary market—will vary depending on the specifics of the Project that is built, including the diameter of the pipe, the points of interconnection with other pipelines, the size of such interconnections, and the upstream and downstream terminuses.

Third, the shipper should know how the capacity for which it is subscribing fits into the overall project, so that it can determine whether it is being asked to bear a fair share of the costs.

Additionally, shippers should verify that the expansion project is defined in the PA in the same way it was described in the open season notice. If the scope of the project has changed materially (*e.g.*, significant changes to the length or diameter or the pipeline, or the number or size of any laterals), there should be a corresponding change in the rate.

g. Receipt/Delivery point flexibility

In selecting one's primary receipt and delivery point(s) under a PA, the shipper should take into account certain principles that may affect the value of the subscribed capacity. First, in Order No. 636, the Commission established the principle that shippers must be allowed to change receipt and delivery point(s), subject to the availability of capacity at the new point(s), so they can receive and deliver gas to any point within the firm capacity rights for which they pay.⁵⁶ This means a shipper may or may not be able to change its primary receipt and/or delivery points

⁵⁵ *Id.* at P 74, 77.

⁵⁶ *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation ; and Regulation of Natural Gas Pipelines After Wellhead Decontrol*, Order No. 636, F.E.R.C. STATS. & REGS., Regulations Preambles, ¶ 30,939 at 30,428–29 (1992), *order on reh'g*, Order No. 636-A, F.E.R.C. STATS. & REGS. ¶ 30,950, *order on reh'g*, Order No. 636-B, 61 F.E.R.C. ¶ 61,272, 57 Fed. Reg. 57,911 (1992), *order on reh'g*, 62 F.E.R.C. ¶ 61,007 (1993), *aff'd in part and remanded in part sub nom. United Distribution Cos. v. FERC*, 88 F.3d 1105 (D.C. Cir. 1996), *order on remand*, Order No. 636-C, 78 F.E.R.C. ¶ 61,186 (1997) [hereinafter Order No. 636].

to an intermediate point or points, depending on how constrained the pipeline is at the newly desired point(s) at the time the shipper wishes to make the change.

Second, even if a shipper does not wish to change its primary receipt/delivery point(s) or is unable to do so, the shipper may still be able to utilize alternate receipt/delivery point(s) on a secondary basis (*i.e.*, subject to curtailment in times of constraint in favor of shippers utilizing their primary point rights). Access to secondary receipt and delivery points is always only available to the extent those points have excess capacity.⁵⁷

Third, primary points usually have same priority, but not always. Shippers should check the pipeline's tariff to see whether different rate schedules have different priorities.⁵⁸

h. Obligations of shipper

The pipeline's proposed PA may require that the shipper agree to reasonably support and cooperate with the efforts of pipeline to obtain a FERC certificate and the other permits and authorizations needed to construct the project. When presented with such a provision, the shipper may insist that such obligation be expressly conditioned on the pipeline taking actions that are consistent with the terms agreed to in the PA, preserving the shipper's ability to challenge proposals in the FERC certificate application that conflict with the PA. Further, shippers may seek reciprocal language from the pipeline to support (or at the very least, not oppose) any efforts of the shipper to obtain approvals for any facilities that the shipper will need to construct in connection with the project, as well as any similar efforts by upstream and/or downstream transporters on which the shipper will rely.

PAs typically require the shipper to execute a TSA that is substantially in the form of a *pro forma* TSA attached to the PA within a specified number of days after execution of the PA or some other triggering event.

Finally, under current market conditions, it has become a relatively common practice for pipelines to require that shippers who terminate a PA (or whose creditworthiness, actions, or inactions cause the pipeline to terminate the PA) bear their ratable share of so-called pre-service costs under certain circumstances. Pre-service costs are costs incurred by the pipeline in pursuing the project and can, in some circumstances, be substantial.

i. Obligations of pipeline

The PA typically includes terms requiring the pipeline to proceed with due diligence (sometimes using commercially reasonable efforts) to obtain the authorizations needed for the project and to complete the construction in a timely manner so that it is able to achieve the target service commencement date. This protects the shipper from the possibility of the pipeline

⁵⁷ See *e.g.*, *Rockies Express Pipeline L.L.C.*, 150 F.E.R.C. ¶ 61,161 at P 15; *Transcontinental Gas Pipe Line Corp.*, 104 F.E.R.C. ¶ 61,171 at P 25 (2003), *order on reh'g*, 107 F.E.R.C. ¶ 61,156 at P 11 (2004) ("The shipper has no guaranteed firm right to use these secondary points, however, since shippers using their primary firm capacity have priority."), *aff'd*, *Exxon Mobil Corp. v. FERC*, 430 F.3d 1166 (D.C. Cir. 2005).

⁵⁸ See *Central New York Oil and Gas Co., L.L.C.*, 152 F.E.R.C. ¶ 61,097 at P 35, n. 54 (2015).

suspending action to advance the project while it explores and/or pursues other market opportunities.

However, it is also typical that the pipeline will propose language in the PA reserving its right to proceed in a manner it deems in its best interest to complete the necessary design, acquisition of materials, rights-of-way, and regulatory authorizations prior to satisfaction or waiver of certain specified conditions precedent.

In response, shippers may seek PA language providing that (a) once the specified conditions precedent are met, pipeline shall proceed with due diligence to construct the project so that it is prepared to commence service on the target service commencement date, and (b) if the pipeline is unable to commence on expected commencement date, the pipeline shall proceed with due diligence to complete construction and commence transportation service as soon thereafter as practicable. Finally, depending on market conditions, a shipper may seek PA language awarding it liquidated damages in the event of a service commencement date delay of a specified length not caused by an event of *force majeure*.

j. Interconnection/taps

Although all project costs are normally recovered through the transportation rate stated in the PA, the shipper may wish to ensure that there is no ambiguity as to who will be responsible for the cost of interconnections/taps. Additionally, there should be no ambiguity as to the location of interconnections/taps, construction responsibility, and who will own metering and regulation station facilities. Where the shipper will be depending on a new, or to-be-expanded, interconnection with an upstream or downstream transporter, the shipper may also wish to ensure that the PA contains terms requiring the pipeline to enter into an interconnection agreement with such transporter(s) by a specified date.

k. Shipper Creditworthiness

Pipelines typically require that all expansion shippers either meet certain specific creditworthiness requirements or provide financial security to protect the pipeline against default. To be considered creditworthy, pipelines commonly require that the shipper have a credit rating for long-term senior unsecured debt from Moody's Investors Service, Inc. of Baa3 or higher and from Standard & Poor's of BBB- or higher. Oftentimes, the shipper does not itself have a credit rating, but its parent company does. In such cases, a parental guarantee may be required.

Pipelines may propose PA language providing that, if at any time a creditworthy shipper or guarantor ceases to meet the definition of creditworthy, the pipeline can require the shipper to provide financial security in the form of cash prepayment, an irrevocable standby letter of credit, or a guarantee from a creditworthy party. The collateral amount for such financial security can essentially be as high as the market will bear because FERC does not regulate the amount required in pipeline PAs, so long as the pipeline is not unduly discriminating amongst shippers. Thus, although FERC policy generally prohibits pipelines from requiring more than three months of financial security when they sell existing capacity, pipelines constructing new capacity can and often do require the posting of a year or more of financial security by shippers who do not

meet the creditworthiness standard.⁵⁹ The financial security required for an expansion project is frequently tied to the shipper's MDQ, such that the shipper is required to provide financial security for an amount equal to x months/years of demand charges under the transportation agreement contemplated by the PA.

l. Pre-Service Costs

Pipelines may seek language obligating the shipper to bear its proportionate share of project costs incurred by the pipeline if the PA is terminated by the shipper in circumstances in which the shipper is considered at fault or where the shipper fails to meet material conditions or obligations as spelled out in the PA (*e.g.*, failure to post required financial security by a date certain, failure to execute the TSA by the deadline specified in the PA).

When presented with such a pre-service cost provision, the shipper may wish to limit its exposure by insisting on additional language (1) stating that the pipeline will seek to mitigate any early termination damages in a commercially reasonable manner, such as by remarketing the capacity to others, terminating the project, or downsizing the project; (2) providing that to the extent the pipeline mitigates its damages, the shipper receives a refund or credit for the money saved; and (3) specifying that the shipper's pre-service cost exposure is limited to a proportionate share of the overall project and that this percentage share will not increase if the pipeline is unable to secure other agreements or if any of the pipeline's other PAs terminate early. Today, a percentage cap on pre-service costs is particularly valuable as it can insure that an expansion shipper is not disproportionately burdened if, as a result of declining gas prices, another expansion shipper is thereafter unable to meet its financial obligations to the pipeline.

m. Role of PA in FERC Proceedings

Unlike TSAs, the specific terms and conditions contained in PAs are not routinely evaluated by the FERC unless requested to do so by the pipeline. PAs are largely treated by FERC as non-jurisdictional, commercial matters which the Commission leaves the parties generally free to negotiate as they see fit. Thus, there are no *pro forma* precedent agreements in a pipeline's tariff, there is no maximum amount of financial security that a pipeline can require of an expansion shipper deemed not creditworthy as long as such policies are non-discriminatory,⁶⁰ and there is no generic set of required or prohibited terms. However, PAs can have significant commercial meaning down the road. For example, where a dispute arises over the terms of a TSA and the TSA language is deemed ambiguous, the Commission may rely on language in a PA to interpret the parties' intent.⁶¹ Moreover, where a PA sets forth creditworthiness requirements that vary from those in the pipeline's tariff, those PA provisions typically remain in effect even after the TSA is executed, the balance of the PA is terminated and service commences.

⁵⁹ See, *e.g.*, *Reliant Energy Servs., Inc. et al. v. Kern River Gas Transmission Co.*, 120 F.E.R.C. ¶ 61,056 at PP 3, 28–29 (2007).

⁶⁰ See *Calpine Energy Servs., L.P. v. Southern Natural Gas Co.*, 103 F.E.R.C. ¶ 61,273 at PP 35–37 (2003).

⁶¹ *Central New York Oil and Gas*, 152 F.E.R.C. ¶ 61,097 at P 32.

Pipelines are required to file expansion PAs with FERC as an exhibit to their certificate applications as part of their showing of market need for the project.⁶² When they do so, however, pipelines routinely file the PAs under seal and request that they be accorded privileged treatment on the basis that information in the PAs is exempt from mandatory public disclosure under the Freedom of Information Act. To obtain privileged treatment however, FERC regulations not only require that the pipeline designate the document as privileged, but also include a justification for privileged treatment and submit a model protective order together with a public version of the document with the privileged information redacted.⁶³

Typically, the pipeline designates its PAs as privileged because they include “commercially sensitive information.” However, when challenged, the Commission may deny such requests for privileged and confidential treatment of PAs and instead require public disclosure.⁶⁴ Alternatively, the Commission may require the pipeline to produce the PAs to a contesting party subject to the terms of the Protective Order.⁶⁵ FERC also typically requires a pipeline, as a condition in the order granting certificate, to execute firm contracts for the capacity levels and terms of service represented in the signed PAs prior to commencing construction.⁶⁶

As discussed *infra*, TSAs, by contrast, must be entirely consistent with the *pro forma* form of service agreement in the pipeline’s tariff. Where they are not, the pipeline must publicly file the non-conforming TSA terms and conditions and seek Commission approval.

III. Transportation Service Agreements

a. The Legal Framework

Under Section 4(c) of the NGA, and the Commission’s implementing regulations,⁶⁷ pipelines must file all contracts which “in any manner” affect the services the pipeline provides to its customers unless the particular contract fully conforms to the Form of Service Agreement set forth in the pipeline’s tariff. If the contract does not fully conform, to wit, where it “deviates in any material aspect from the Form of Service Agreement in the tariff,” it must be filed as a “non-conforming” agreement for Commission acceptance.⁶⁸ A material deviation which renders a contract “non-conforming” is “any provision of a service agreement which goes beyond filling in the spaces in the Form of Service Agreement with the appropriate information provided for in the tariff, and that affects the substantive rights of the parties.”⁶⁹

⁶² 18 C.F.R. § 157.14(a) (2015).

⁶³ See 18 C.F.R. § 388.112(b)(1)–(2) (2015).

⁶⁴ See, e.g., *See Algonquin Gas Transmission, L.L.C.*, 130 F.E.R.C. ¶ 61,011 at PP 47–48 (2010).

⁶⁵ See, e.g., *Texas Eastern Transmission, L.P.*, 145 F.E.R.C. ¶ 61,027 at P 11 (2013).

⁶⁶ See, e.g., *Constitution Pipeline Co. L.L.C.*, 149 F.E.R.C. ¶ 61,199 at Ordering Paragraph (G) (2014).

⁶⁷ 18 C.F.R. §§ 154.1(b),(d); 154.110; 154.112(b) (2015).

⁶⁸ 18 C.F.R. §§ 154.1(d); 154.112(b) (2015).

⁶⁹ *ANR Pipeline Co.*, 97 F.E.R.C. ¶ 61,224, at p. 62,022 (2001) (footnote omitted).

Non-conforming provisions that are determined by the Commission to create no risk of undue discrimination are accepted on a case-by-case basis. Non-conforming provisions found to create a risk of undue discrimination are prohibited unless the pipeline modifies its tariff to offer the same terms to all its customers or it can demonstrate why it is not unduly discriminatory for it to offer the non-conforming provision to this single customer.⁷⁰

The Commission, as a general matter, prohibits pipelines from negotiating any terms and conditions of service with individual customers because it views this practice as creating a risk of undue discrimination. In Order No. 637,⁷¹ the Commission stated that such prohibited negotiated terms and conditions include those related to the operational conditions of transportation service and offered as examples, “scheduling, imbalances, or operational obligations such as OFOs.”⁷² Subsequently, the Commission more broadly stated that prohibited negotiated terms and conditions include any contract provision that results in a customer receiving a different quality of service that that provided to other customers under the tariff or that affect the quality of service received by other customers.⁷³

Pipelines that have been granted negotiated rate authority by the Commission are permitted to negotiate rates that deviate from those set forth in their generally applicable tariff rate schedules as long as the shipper also has the option of alternatively selecting an applicable cost-of-service based recourse rate. The availability of an adequately alternative recourse rate as a service option, the Commission has concluded, serves to mitigate for the pipeline’s market power.⁷⁴ Negotiated rate terms that may be individually negotiated include the price, the term of service, the receipt and delivery points and the quantity of the transportation service selected.⁷⁵

Where a pipeline and customer agrees to a negotiated rate for a service expansion, the pipeline historically has been at risk for any cost under recovery.⁷⁶ This is to be contrasted with a

⁷⁰ *ANR Pipeline Co.*, 97 F.E.R.C. ¶ 61,224, at p. 62,024, (stating that “material deviations from the Form of Service Agreement fall into two general categories – those that must be prohibited because they present a significant potential for undue discrimination among shippers and those that can be permitted without substantial risk of undue discrimination.”) See also *Tennessee Gas Pipeline Co.*, 97 F.E.R.C. ¶ 61,225, at pp. 62,028–62,029 (2001); *Columbia Gas Transmission Corp.*, 97 F.E.R.C. ¶ 61,221, at p. 62,002 (2001).

⁷¹ *Regulation of Short-Term Natural Gas Transp. Servs., and Regulation of Interstate Natural Gas Transportation Servs.*, Order No. 637, 90 F.E.R.C. ¶ 61,109 (2000) (codified at 18 C.F.R. pts. 154, 161, 250, 284) [hereinafter Order No. 637].

⁷² *Tennessee Gas Pipeline Co.*, 97 F.E.R.C. ¶ 61,225, at p. 62,029 (citing Order No. 637).

⁷³ *ANR Pipeline Co.*, 97 F.E.R.C. ¶ 61,224, at p. 62,024; *Monroe Gas Storage Co., L.L.C.*, 130 F.E.R.C. ¶ 61,113 at P 28 (2010).

⁷⁴ See *Alternative Rate Policy Statement*, 74 F.E.R.C. ¶ 61,076, at p. 61,240.

⁷⁵ See, e.g., *Tennessee Gas Pipeline Co.*, 97 F.E.R.C. ¶ 61,225, at p. 62,029 (citing Order No. 637). Where a pipeline enters into a negotiated rate transaction that otherwise does not deviate from its *pro forma* service agreement, it may file with the Commission a tariff sheet reflecting the terms of the agreement, together with a statement that the agreement conforms in all material respects with its *pro forma* service agreement. *Natural Gas Pipeline Negotiated Rate Policies and Practices*, 104 F.E.R.C. ¶ 61,134 at P 32 (2003).

⁷⁶ *NorAm Gas Transmission Co.*, 77 F.E.R.C. ¶ 61,011, at p. 61,041 (1996). Admittedly, the Commission has never adopted a generic *per se* rule prohibiting pipelines from seeking a discount like adjustment for negotiated rate

discounted rate agreement where pipelines can, and routinely do seek to roll-in and thereby recover the costs associated with discounted TSAs in a subsequent rate case.⁷⁷

Under the Commission's Certificate Policy Statement, expansions are generally required to be priced incrementally although there are some circumstances where an expansion project's costs can be included in existing shippers' rates. For example, rolled-in pricing of an expansion may be appropriate where an initial costly expansion resulted in cheap expansibility.⁷⁸ As such rate issues can be contentious; the Commission expects pipelines to address issues regarding the rate treatment of such cheap expansibility before the initial expansion is constructed.⁷⁹

Pipelines must file all TSAs containing non-conforming provisions with the Commission thirty days before service is expected to commence. As the PAs are generally confidential, it is only when the TSAs are filed that expansion shippers can verify the terms and conditions offered to other expansion shippers. Expansion shippers should confirm that the pipeline has offered the same non-conforming provisions to all similarly situated expansion shippers. If a shipper feels it has not been fairly treated, it has the ability to intervene and raise an undue discrimination claim with the Commission.

b. Permitted Material Non-Conforming Provisions

The Commission has found that Most Favored Nations (MFN) clauses in TSAs do not create a risk of undue discrimination and are permitted non-conforming provisions.⁸⁰ MFN clauses require the pipeline, if it subsequently offered a more favorable rate for comparable service to a new shipper, to give that same lower rate to the shipper with the MFN clause in its TSA. However, the value of such MFN provisions to expansion shippers have proven to be fairly limited because the Commission has been willing to construe such provisions narrowly and pipelines have had good success designing subsequent expansion projects that are sufficiently different from the original project so that MFN rights held by the original expansion shippers are not triggered.⁸¹ This fact should be taken into account when bargaining for one in a PA or TSA.

A range of non-material and thus permissible non-conforming provisions are offered by pipelines as inducements to shippers to sign up for capacity as an anchor shipper in response to a

agreements. *See e.g., Texas Gas Transmission, L.L.C.*, 138 F.E.R.C. ¶61,175 (2012) at P 32 (*citing Tennessee Gas Pipeline Co.*, 135 F.E.R.C. 61,208 (2011)). However, the pipeline must demonstrate not only that the negotiated rate discount was needed to meet competition but also that recourse rate shippers are protected from inappropriate cost-shifting. *See, e.g., Wyoming Interstate Co., Ltd.*, 117 F.E.R.C. ¶ 61,150 (2006); *CNG Transmission Corp.*, 80 F.E.R.C. ¶ 61,401, at p. 62,327–62,328 (1997).

⁷⁷ *Southern Natural Gas Co.*, 94 F.E.R.C. ¶ 61,297 (2001).

⁷⁸ Certificate Policy Statement, 88 F.E.R.C.¶ 61,227, at p. 61,746–61,747. *See also, Colorado Interstate Gas Co.*, 122 F.E.R.C. ¶ 61,256 at P 59 (2008).

⁷⁹ Certificate Policy Statement, 88 F.E.R.C.¶ 61,227, at p. 61,746.

⁸⁰ *Gulfstream Natural Gas System, L.L.C.*, 100 F.E.R.C. ¶ 61,036 at P 16 (2002); *Colorado Interstate Gas Co. and Cheyenne Plains Pipeline Co., L.L.C.*, 106 F.E.R.C. ¶ 61,275 at P 39 (2004).

⁸¹ *See, e.g., Rockies Express Pipeline L.L.C.*, 145 F.E.R.C. ¶ 61,179 at 44–46 (2013); *Central New York Oil Gas Co., L.L.C.*, 152 F.E.R.C. ¶ 61,097 at P 27.

pipeline's expansion open season notice. For example, a pipeline can provide an anchor shipper: a guaranty that its capacity subscription will not be reduced if the project is subsequently oversubscribed; an option to extend the primary term at a negotiated rate upon prior notice; and the right to have a negotiated rate apply to segmented quantities, future delivery/receipt point amendments, and to service at secondary points.⁸² Such provisions are viewed by the Commission as contract incentives to attract shippers to a new project. Since they are made generally available in the notice of open season, they do not create a risk of undue discrimination among shippers.⁸³

Provisions sharing the economic risk of an expansion between pipelines and its expansion shippers are also permitted. These include provisions requiring shippers to maintain a minimum credit rating, granting the shipper a right to terminate the TSA if the pipeline fails to begin service by a date certain, and giving the pipeline a right to file to amend initial negotiated rates if final construction costs exceed a defined limit, subject to a cost cap.⁸⁴ The Commission has also allowed non-conforming provisions requiring a shipper to pay for service on a fixed date, even if it is not yet taking service as of that date.⁸⁵

c. Prohibited Material Non-Conforming Provisions

FERC has prohibited provisions giving an expansion shipper a "first priority right" in future contract "reduction" situations.⁸⁶ The Commission has found that contract demand reduction provisions are valuable rights and pipelines must file generally applicable tariff provisions for Commission approval to insure that such rights are negotiated on a not unduly discriminatory fashion.⁸⁷ Similarly, the Commission has disallowed provisions giving a shipper an early contract termination right.⁸⁸

Consistent with its concerns about preferential allocation of future cheap expansibility, the Commission has, for example, prohibited a contract provision giving an expansion shipper a preferential right to acquire capacity on any future lateral expansion project over the next ten years that consists solely of the addition of compression.⁸⁹ The Commission has also disallowed

⁸² *Tennessee Gas Pipeline Co.*, 136 F.E.R.C. 61,173 ¶ at P 40 (2011).

⁸³ *See, e.g., Columbia Gas Transmission, L.L.C.*, 153 F.E.R.C. ¶ 61,146 at P 9 (2015); *Tennessee Gas Pipeline Co.*, 136 F.E.R.C. ¶ 61,173 at P 43; *Midcontinent Express Pipeline L.L.C.*, 124 F.E.R.C. ¶ 61,089 at P 82 (2008); *Rockies Express*, 116 F.E.R.C. ¶ 61,272 at P 78.

⁸⁴ *See* Letter Order issued on April 7, 2009 in Docket No. RP09-442-000 (accepting Columbia Gas Transmission, LLC's March 9, 2009 filing of a series of non-conforming service agreements with the City of Charlottesville, VA).

⁸⁵ *Columbia Gas Transmission, L.L.C.*, 153 F.E.R.C. ¶61,146 at P 10.

⁸⁶ *Kern River Gas Transmission Co.*, 94 F.E.R.C. ¶61,161, at p. 61,585 (2001). *Tennessee Gas Pipeline Co.*, 97 F.E.R.C. ¶ 61,225, at p. 62,029. Alternatively, this provision may be permitted if it is offered in an open season notice as available to all anchor shippers. *See, e.g., Ruby Pipeline*, 128 F.E.R.C. ¶ 61,224 at PP 75, 84; *Columbia Gas Transmission*, 153 F.E.R.C. ¶61,008 at P 17.

⁸⁷ *See Colorado Interstate Gas Co.*, 101 F.E.R.C. ¶ 61,268 at P 13 (2002).

⁸⁸ *WBI Energy Transmission, Inc.*, 148 F.E.R.C. ¶ 61,119 at P 7 (2014).

⁸⁹ *Northwest Pipeline Corp.*, 97 F.E.R.C. ¶ 61,163, at p. 61,731 (2001).

contract provisions allowing a shipper to vary its contract demand by fixed amounts during the term of the agreement except where this right is offered to all anchor shippers via an open season.⁹⁰

In any negotiation for expansion capacity, it is important for the prospective purchaser of pipeline capacity to know whether non-conforming provisions being considered for the TSA are likely to be approved under the Commission's criteria.

d. Relationship of TSA to PA

Many PAs provide that the terms of the agreement, with the exception of the creditworthiness provisions, terminate upon the effectiveness of the TSA.⁹¹ The TSA, in turn, will generally take effect upon the in-service date of the project.⁹² As noted previously, although PAs are filed with the Commission in the expansion certificate proceeding, in many instances, pipelines file such PAs on a privileged and confidential basis, thereby precluding other shippers on the pipeline from gaining access.⁹³

In contrast, all non-conforming TSAs must be filed publically with the FERC thirty days before they are to take effect. The terms of the TSA control over the terms of the PA. However, the Commission may look to the PA to interpret the intent of the TSA where the TSA language is deemed ambiguous.⁹⁴

IV. Conclusion

With the surge of pipeline expansion projects in development in the wake of the fracking revolution, companies looking to secure additional transportation capacity need to be aware of the rules governing the terms under which they can acquire such capacity. A close understanding of the flexibility pipelines have and the most commonly negotiated terms will help prospective shippers maximize their capacity's value and utility.

⁹⁰ *Columbia Gas Transmission*, 149 F.E.R.C. ¶ 61,146 at P 32.

⁹¹ This is because the Commission allows more stringent creditworthiness provisions for new capacity expansion shippers as compared to the tariff provisions which govern creditworthiness for shippers acquiring existing pipeline capacity. *See, e.g., Calpine Energy Servs., L.P. v. Southern Natural Gas Co.*, 103 F.E.R.C. ¶ 61,273 at P 36.

⁹² In some instances, pipelines can provide interim or limited service before an expansion is fully in service. In such instances, additional TSAs governing this early service will be filed with the Commission. *See, e.g., Letter Order issued on September 10, 2015 in Docket No. RP15-1195-000 et al.* (accepting Texas Eastern Transmission, L.P.'s August 14, 2015 OPEN Project compliance filings re the Ohio Pipeline Energy Network Project.).

⁹³ *But see Texas Eastern Transmission*, 145 F.E.R.C. ¶ 61,027 at P 11.

⁹⁴ *See, e.g., Central New York Oil and Gas Co., L.L.C.*, 152 F.E.R.C. ¶ 61,097 at P 32.