108 FERC ¶ 61,328
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Southern Natural Gas Company — Docket No. RP04-523-000

ORDER ACCEPTING AND SUSPENDING TARIFF SHEETS, SUBJECT TO REFUND AND CONDITIONS, AND ESTABLISHING TECHNICAL CONFERENCE AND HEARING PROCEDURES

(Issued September 30, 2004)

1. On August 31, 2004, Southern Natural Gas Company (Southern) filed revised tariff sheets under section 4(e) of the Natural Gas Act (NGA) to be effective on October 1, 2004, reflecting an overall increase in jurisdictional rates of approximately 10 percent or $35 million annually and proposing changes to rate schedules and the General Terms and Conditions (GT&C) of its tariff.[1] Southern also filed pro forma tariff sheets to be effective prospectively from the date of a Commission order approving the changes.[2]

2. The Commission accepts and suspends certain of the revised tariff sheets for the maximum five months statutory period to be effective on March 1, 2005, subject to refund and subject to the outcome of a hearing established by this order, or pending the outcome of a technical conference and further Commission orders. The Commission also accepts and suspends certain of the revised tariff sheets to be effective October 1, 2004, subject to refund and the outcome of the technical conference. The disposition of the pro forma tariff sheets is made subject to the outcome of the technical conference and further Commission orders. Finally, the Commission accepts certain tariff sheets to become effective on October 1, 2004, as proposed by Southern, subject to conditions. This order benefits the public by ensuring that Southern's jurisdictional rates and terms and conditions of service are just and reasonable.

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[1] The proposed tariff sheets are listed on Appendices A and B to this order.

[2] Pro Forma Sheet Nos. 144A and 240.

Background

3. Southern states that its transmission system consists of two roughly parallel main lines, i.e., the north and south systems, with extensions to Chattanooga, Tennessee, Huntsville/Decatur, Alabama, and Savannah, Georgia; the South Georgia Natural Gas Company (South Georgia) facilities that extend to Jacksonville, Florida; the Muldon, Mississippi (100 percent Southern ownership) and Bear Creek, Louisiana (50 percent Southern ownership) underground storage fields; the production area facilities in Texas and Louisiana; and the offshore supply system in the Gulf of Mexico. Southern is directly connected to the Southern LNG, Inc. (Southern LNG) Elba Island LNG import terminal at the eastern end of its system by twin 30-inch diameter pipelines that Southern co-owns with SCG Pipeline, a subsidiary of SCANA Corp. Along its route, Southern interconnects with several other interstate and intrastate pipeline and gathering systems.

4. Southern indicates that its current system design capacity is about 3.4 Bcf per day. Southern claims the pipeline operates as an integrated system on which the gas still generally flows east from production areas offshore and in Louisiana and Mississippi to Southern's primary market area in Alabama, Georgia, and South Carolina.

5. Southern explains that it provides firm (FT) and interruptible (IT) transportation services and firm (CSS) and interruptible (ISS) storage services, with customers holding both firm transportation and firm storage allowed to receive firm no-notice service (FT-NN). Southern further states that it provides an interruptible park and loan service (PAL). Southern also filed gathering service rates which, states Southern, it expects to be discontinued upon abandonment and sale of its gathering facilities during the test period.[3]

A. Southern's Rate Proposal

6. Southern states that it filed the revised tariff sheets to comply with the requirements of the March 10, 2000 Stipulation and Agreement in Docket Nos. RP99-496-000 and RP99-496-001 (Stipulation and Agreement). According to Southern, Article IV, Section 1 of the Stipulation and Agreement requires it to file a new general rate case no later than September 1, 2004, to be effective no later than March 1, 2005.[4]

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[3] By delegated letter order issued on September 27, 2004, in Docket No. RP04-455-000, the revised tariff sheets eliminating the gathering service rates from Southern's tariff were accepted.

[4] Southern states that the Commission approved the Stipulation and Agreement in an order dated May 31, 2000. *Southern Natural Gas Co*., 91 FERC ¶ 61,206 (2000).

7. Southern further states that it has derived its rates based on a test period consisting of a 12-month base period ended April 30, 2004, adjusted for known and measurable changes anticipated to occur during the 9-month adjustment period ending January 31, 2005. Southern asserts that the revised jurisdictional rates are intended to avoid an under-recovery of its cost of service. Southern proposes an annual cost of service of $439,556,447 primarily to reflect increases in (1) operation and maintenance (O&M) expenses, (2) the overall depreciation expenses, and (3) the overall rate of return and related taxes. Southern proposes 35,510,231 Dth of annual demand billing determinants and 602,127,192 Dth of annual throughput, as adjusted for discounting.

1. Retention of Current Cost Classification, Allocation, and Rate Design Methods

8. Southern states that many components of its proposed rates represent a continuation of approved practices. Southern explains that it generally retains the methods of cost classification, allocation, and rate design that underlie its currently-effective rates. For example, Southern states that it continues to (1) design its rates using the straight fixed-variable (SFV) method preferred by the Commission,[5] (2) employ zone of delivery reservation rates calculated with reference to the current zonal boundaries of its system, (3) design its IT rates as a 100-percent load factor derivative of its FT rates, utilizing a zone matrix methodology, (4) allocate its total storage costs between pipeline transportation services and unbundled storage services, and (5) design its rates for firm storage service based on the methodology adopted by the Commission.[6]

2. Merger of Subsidiary

9. Southern further states that the Stipulation and Agreement provided that a subsidiary of Southern, South Georgia, would be merged into Southern and that an incremental rate, based on an allocation of the combined costs of service of the South Georgia facilities and Southern's existing facilities, would be applied for service on the South Georgia facilities. Southern maintains that it has continued this rate methodology in this filing.

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[5] Southern cites 18 C.F.R. § 284.7(e) (2004); *Northern Natural Gas Co.*, 105 FERC ¶ 61,299 at P 14 (2003) (*Northern Natural*); *Texas Eastern Transmission, LP*, 101 FERC ¶ 61,120 (2002) (*Texas Eastern*).

[6] Southern cites *Equitable Gas Co.*, 36 FERC ¶ 61,147 (1986).

3. **Conversion to FT Service**

10. Additionally, states Southern, the Stipulation and Agreement provided that Southern would convert a firm transportation service, known as the ANR Storage Transportation Service (STS), certificated under Part 157 of the Commission's regulations to a service performed under Part 284 of the Commission's regulations and Southern's existing FT Rate Schedule. The conversion is expected to occur as of October 1, 2004. Southern submits that it has treated this service as a Part 284 transportation service for rate purposes in this filing.

4. **Rate of Return and Cost of Capital**

11. Southern has proposed a 13.5 percent rate of return on equity (ROE) based on the pipeline’s capital structure of 47.44 percent debt and 52.56 percent equity, and a 8.20 percent cost of debt. Southern explains that the revised tariff sheets reflect an overall rate of return on rate base of 10.99 percent versus the 10.24 percent rate of return approved by the Commission in the Stipulation and Agreement of Southern's last rate case.

12. According to Southern, use of its own capital structure is consistent with Commission policy because Southern issues its own non-guaranteed debt, has a bond rating separate from its parent, and has an equity ratio that is within the range of equity ratios approved by the Commission it its recent orders. Further, states Southern, the filed ROE of 13.5 percent falls below the reasonable range of the cost of equity for natural gas pipelines, determined using the Commission’s preferred discounted cash flow (DCF) methodology. Southern asserts that its capital structure reflects average risk, even though it faces substantial competition in the markets it serves and near-term recontracting risk. However, Southern states that it seeks a ROE slightly below the range of returns authorized by the Commission for other pipelines in recognition of the competitive pressures in its markets.

5. **Rolled-in Rate Treatment for System Expansions**

13. Southern also proposes to roll into systemwide rates the costs of three major system expansions, as well as the costs of various other facilities that either added smaller increments to Southern's system capacity or improved the reliability and efficiency of the system. Southern contends that the facilities constructed pursuant to its blanket certificate automatically receive a predetermination of rolled-in rate treatment pursuant to Commission policy.[7]

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[7] Southern cites *Tennessee Gas Pipeline Co*., 93 FERC ¶ 61,332 (2000).

6. Depreciation Rates

14. Although Southern maintains that its evidence supports an increase from 1.47 percent to 2.22 percent in the depreciation rate applicable to onshore transmission facilities, Southern states that it proposes to use a 2.00 percent rate for these facilities, in accordance with the Stipulation and Agreement. Southern also proposes to increase the depreciation rate applicable to underground storage transmission facilities to 1.24 percent from the current rate of 0.80 percent and to reduce the depreciation rate applicable to offshore transmission facilities to 0.74 percent from the current rate of 1.10 percent. Southern observes that the net effect of these changes is an increase in Southern's annual depreciation expense by approximately $12 million. Southern proposes that all its other depreciation rates remain unchanged.

7. Reclassification of Wrens-Savannah Line

15. Southern proposes to change the classification of its Wrens-Savannah Line facilities from nonmileage to mileage-based because of the reactivation of Southern LNG’s terminal located at the east end of this line. According to Southern, this will make the classification of these facilities consistent with all other transmission facilities other than Southern’s measurement stations.

8. PAL Service

16. Southern states that, since its last general rate case, it has initiated a new Rate Schedule PAL service. Southern indicates that PAL rates have been designed using the methodology that was approved by the Commission. However, Southern also explains that market fluctuations make it impossible to fix a rate that would generate revenues consistent with its base period experience. Therefore, explains Southern, it has not allocated costs to that rate schedule, but instead proposes to credit the test period revenues derived from the Rate Schedule PAL service to the transmission function cost of service.

9. Increased O&M Expenses

17. Southern explains that the revised tariff sheets reflect O&M expenses in the amount of $137,839,852. Southern states that this is an increase of $14,127,959, or 11 percent, above the O&M expenses approved by the Commission in Docket Nos. RP99-496-000 and RP99-496-001. Southern further states that its actual O&M expenses incurred during the base period were $175,000,329 and that it has adjusted this amount to reflect known and measurable changes expected to occur before the end of the test period on January 31, 2005. In general, contends Southern, this falls within two broad categories. First, states Southern, it eliminated base period expenses that are recovered through

separate surcharges, and then it examined each category of expenses and increased or decreased the amount as appropriate to ensure a representative level of that category for future recovery.

B. Southern's Proposed Revisions to the GT&C and Rate Schedules

18. Southern proposes several tariff revisions to the GT&C and its rate schedules. These revisions relate to right of first refusal (ROFR) rights, discounting, turnback capacity, the award of receipt and delivery points, cash out price calculation, other miscellaneous changes, and pro forma revisions addressing the application of the Storage Cost Reconciliation Mechanism (SCRM). The specifics of the proposed and pro forma tariff revisions are discussed below.

Notice, Interventions, Protests, and Answers

19. Notice of Southern's filing was issued on September 2, 2004. Interventions and protests were due September 13, 2004, as provided in section 154.210 of the Commission's regulations.T[8] Pursuant to Rule 214,[9] all timely-filed motions to intervene and any motions to intervene out-of-time filed before the date of issuance of this order are granted. Granting late intervention at this stage of the proceeding will not delay or disrupt the proceeding, nor will it place additional burdens on existing parties.

20. A number of parties filed timely protests.[10] The issues raised by the protesting parties are discussed below. The protesting parties generally ask the Commission to reject or modify particular tariff provisions, suspend the filing for the maximum statutory period, establish a technical conference, or establish hearing procedures.

21. Parties filing protests include: Alabama Gas Corporation (Alabama Gas), Atlanta Gas Light Company and Chattanooga Gas Company (Atlanta and Chattanooga), Calhoun Power Company I, LLC (Calhoun), Calpine Corporation (Calpine), Duke Energy Trading

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[8] 18 C.F.R. § 154.210 (2004).

[9] 18 C.F.R. § 385.214 (2004).

[10] BG LNG Services, LLC filed a protest, but has subsequently withdrawn its protest, without prejudice to its right to take a position on any issue in the proceeding at a later time.

and Marketing, L.L.C. (DETM) and Duke Energy Marketing, L.L.C. (DEMA),[11] Georgia Industrial Group (GIG), Indicated Shippers,[12] Municipals,[13] PCS Nitrogen Fertilizer, L.P. (PCS), Peoples Gas System (Peoples), Shell NA LNG, LLC (Shell LNG), and Southern Cities.[14] Dalton Utilities (Dalton) and Sequent Energy Management, LP (Sequent) filed comments addressing limited aspects of Southern's filing.

22. The protestors raise numerous issues relating to the cost of service, throughput, and allocation and rate design, including, but not limited to: (1) the proposed rate of return, capital structure, and proxy group used, (2) the proposed changes to depreciation rates and the underlying analysis of supply, (3) the billing determinants used to design rates, including the deletion of base period interruptible throughput, (4) the appropriate level of labor and overheads as a result of the merger with El Paso Corporation and recent reductions in both Southern's and El Paso Corporation's corporate labor forces, (5) the O&M expenses for the South System II expansion, (6) whether the expansion projects meet the requirements for roll-in of the costs into systemwide rates, (7) whether the South Georgia facilities should be rolled-in to Southern's rates, (8) the proposed discount adjustment, (9) issues regarding Southern's rate design and the continued use of zone of delivery reservation rates due to reactivation of Southern LNG's Elba Island LNG terminal, (10) the adoption of a revenue sharing mechanism that would share future revenues from firm service and PAL service originating from the Elba Island LNG terminal, (11) the treatment of facilities abandoned to Atlanta in Docket No. CP04-340, (12) the change in classification of the Wrens-Savannah line from nonmileage to mileage-based, (13) the allocation of storage costs to transmission, including the appropriate level of storage for system balancing purposes, and (14) the costs Southern intends to reallocate to transmission upon the abandonment of its gathering assets.

[11] DETM and DEMA filed a late protest on September 23, 2004. The late-filed protest of DETM and DEMA will not delay the proceeding.

[12] Indicated Shippers include BP America Production Company and BP Energy Company, Chevron U.S.A. Inc., ExxonMobil Gas & Power Marketing Company, a Division of Exxon Mobil Corporation, and Shell Offshore, Inc.

[13] The Municipals include Alabama Municipal Distributors Group, Austell Gas System, Municipal Gas Authority of Georgia, and Southeast Alabama Gas District.

[14] Southern Cities include the City of Tallahassee, Florida, and the Cities of Cordele, Dublin, Cartersville, Cuthbert, Hawkinsville, La Grange, and Tallapoosa, Georgia.

23. In addition, the protests and comments of Alabama Gas, Atlanta and Chattanooga, Calhoun, DETM and DEMA, Indicated Shippers, GIG, Municipals, Peoples, Sequent, Shell LNG, and Southern Cities address aspects of the proposed and pro forma tariff sheet that relate to Southern's GT&C.

24. On September 17, 2004, Southern LDCs[15] filed an answer to the protests of Indicated Shippers, Sequent, and Calhoun to correct what Southern LDCs characterize as misleading and incorrect arguments relating to Southern's proposed change to section 14.1 of the GT&C.

25. Although the Commission's rules prohibit answers to protests, the Commission may, for good cause, waive this provision.[16] The Commission finds good cause to do so in this instance because admitting this pleading will not cause undue delay and will help ensure a complete record in this proceeding.

Discussion

A. Rate Issues

26. The Commission finds that all issues concerning Southern's rate derivation and cost of service, including but not limited to O&M expenses, depreciation rates, rate of return, cost classification, cost allocation and rate design, throughput, discounting, and roll-in issues, should be explored at the hearing established by this order. The Commission accepts and suspends the those tariff sheets listed in Appendix A for the maximum five-month statutory period to become effective on March 1, 2005, subject to refund, and subject to the outcome of the hearing.

B. Proposed Revisions to Rate Schedules and GT&C

27. Southern's proposed revisions to its rate schedules and GT&C are separately discussed below.

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[15] Southern LDCs include: Alabama Municipal Distributors Group, the Austell Gas System, the Municipal Gas Authority of Georgia, the Southeast Alabama Gas District, and Alabama Gas Corporation.

[16] 18 CFR § 385.213(a)(2) (2004).

1. ROFR

a. Southern's Proposal

28. Southern proposes to revise the provisions contained in section 20 of its GT&C relating to a shipper's exercise of the ROFR for firm capacity that is expiring or terminating. Southern contends that its proposal to eliminate the five-year term matching cap is permitted by the Commission's Order on Remand in the Order No. 637 proceeding,[17] and various other orders accepting this type of change.[18]

29. Southern also proposes to (1) specify that it may agree to give ROFR rights to a shipper with a discounted or negotiated rate that is not ordinarily entitled to a ROFR at the expiration of its contract term,[19] (2) specify that a shipper's ROFR may apply to a volumetric portion of a shipper's capacity but not a geographic or seasonal portion,[20] (3) specify the number of days within which a shipper may respond to Southern in the event that Southern does not receive any bids for a shipper's capacity,[21] and (4)

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[17] Southern cites *Regulation of Short-Term Natural Gas Services, and Regulation of Interstate Natural Gas Transportation Services*, 101 FERC ¶ 61,127 (2002).

[18] Southern cites *Northwest Pipeline Corp*., 101 FERC ¶ 61,347 (2002); *Southern Star Central Gas Pipeline Inc*., 103 FERC ¶ 61,172 (2003).

[19] Southern cites *ANR Pipeline Co*., 97 FERC ¶ 61,323 at 62,488 (2002) (*ANR*).

[20] Southern cites *Regulation of Short-Term Natural Gas Transportation Services and Regulation of Interstate Natural Gas Transportation Services*, Order No. 637, FERC Stats. & Regs. (July 1996 - December 2000) ¶ 31,091 at 31,337 (February 9, 2000); *order on reh'g*, Order No. 637-A, FERC Stats. & Regs. (July 1996 - December 2000) ¶ 31,099 (May 19, 2000); *order on reh'g*, Order No. 637-B, 92 FERC ¶ 61,062 (July 26, 2000); *aff'd in part and remanded in part, Interstate Natural Gas Association of America v. FERC*, 285 F. 3d 18 (D.C. Cir. 2002); *order on remand*, (Order No. 637). Southern further cites *ANR Pipeline Co*., 97 FERC ¶ 61,323 at 62,488 (2002); *NUI Corp. v. Florida Gas Transmission Co*., 92 FERC ¶ 61,044 at 61,119 (2000) (*NUI*).

[21] Southern cites *Columbia Gas Transmission Corp*., 107 FERC ¶ 61,078 (2004) (*Columbia Gas*).

specify, consistent with *Texas Eastern*,[22] that a shipper may elect to exercise its ROFR rights when it gives Southern a notice of termination, but absent such an election, the agreement will be subject to pregranted abandonment.[23]

b. Protests

30. Atlanta and Chattanooga do not oppose Southern's proposed ROFR tariff language to the extent that it effectuates the Commission's current policy that, when exercising a ROFR with respect to 365-day capacity, a shipper may not use the ROFR process to reduce or eliminate its contract demand in one season, while retaining all or a portion of its contract demand in the others.[24] Atlanta and Chattanooga also assert that a seasonal shipper with a seasonal contract should not be permitted to exercise its ROFR to selectively reduce volumes in particular months during the contract season. Atlanta and Chattanooga claim that Southern's proposed tariff language should not serve to limit ROFR rights of shippers receiving seasonal service under maximum rate contracts for a term of one year or more.

31. Atlanta and Chattanooga submit that the Commission should reject Southern's proposed 15-day notice period to retain service when no bids are received by Southern, because Southern has provided no explanation why it requires a shorter notice period than the 20-day notice period that the Commission has approved for other pipelines. Municipals also challenge the proposed 15-day requirement.

32. Municipals further state, that with regard to the proposed changes to section 20 of the GT&C, the Commission should require Southern to post any contractual ROFR given in a negotiated rate or discounted rate agreement on Southern's internet website as a

[22] *Texas Eastern Transmission, LP*, 101 FERC ¶ 61,215 (2002).

[23] Southern cites *Algonquin Gas Transmission Co*., 105 FERC ¶ 61,330 (2003); *Columbia Gas Transmission Corp*., 107 FERC ¶ 61,078 (2004); *Gas Transmission Northwest Corp.*, 107 FERC ¶ 61,253 (2004) (*GTN*); *Dominion Transmission, Inc.*, 106 FERC ¶ 61,257 (2004).

[24] Atlanta and Chattanooga cite *NUI Corp. v. Florida Gas Transmission Co.*, 92 FERC ¶ 61,044 (2000); *Algonquin Gas Transmission Co.*, 103 FERC ¶ 61,235 at P 13 (2003); 1996-2000 FERC Stats. & Regs., Regs. Preambles ¶ 31,099, at 31,631 (2000).

special detail pursuant to section 284.13(b)(1)(viii) of the Commission's regulations[25] in order to enable Southern's customers to monitor whether Southern is providing such contractual rights on an unduly discriminatory basis.

33. Additionally, Municipals ask the Commission to revise the language to clarify that Southern and a shipper may mutually agree, on a not unduly discriminatory basis, to extend the 20-business day deadline to facilitate negotiations. Municipals point out that Southern's existing section 20 provides for only a 15-day period for a shipper to respond to bids that are received on the capacity in order to continue firm service, but Municipals requests that period should be summarily extended to 20 business days.

34. Municipals contend that section 20 of the GT&C currently provides a procedure whereby shipper can give notice to terminate the firm service agreement subsequent to the bidding process, at which time, pregranted abandonment would apply. Municipals argue the Commission should require Southern to revise this section to provide that, should a firm shipper provide a notice of termination of its contract, the ROFR will continue to apply unless the shipper explicitly provides notice that it wants to extinguish its ROFR.

c. Commission Analysis

35. Southern's proposal to eliminate the five-year term matching cap (Third Revised Sheet No. 160) is consistent with the Commission's Order on Remand in the Order No. 637 proceeding, and is accepted.

36. Southern also proposes to specify on Third Revised Sheet No. 159 that it may agree to give ROFR rights to a shipper with a discounted or negotiated rate that is not ordinarily entitled to a ROFR at the expiration of its contract term. The Commission will accept the proposed tariff change consistent with *ANR*.[26]

37. In *ANR*, the Commission stated:

> The provision allowing ANR to agree to include a contractual ROFR in discounted recourse rate or negotiated rate agreements is consistent with Order No. 637's authorization of such agreements. However, an agreement to include a ROFR in a discounted recourse rate or negotiated rate agreement

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[25] 18 C.F.R. §284.13(b)(1)(viii) (2004).

[26] *ANR Pipeline Co.*, 97 FERC ¶ 61,323 (2001).

would constitute a special detail that must be included in the transaction information the pipeline is required to post on its Internet web site pursuant to Section 284.13(b)(1)(viii). These reports will enable parties to monitor whether ANR is providing such contractual ROFRs on a not unduly discriminatory basis.[27]

38. Accordingly, the Commission will accept Southern's proposed tariff language, subject to the condition that Southern must post these agreements as a special detail included in transaction information on Southern's internet website, SoNet Premier. This will provide greater transparency to ensure that such transactions will not be provided on an unduly discriminatory basis.

39. Southern also proposes to specify on Third Revised Sheet No. 160 that a shipper's ROFR may apply to a volumetric portion of a shipper's capacity, but not to a geographic or seasonal portion. The Commission accepts the proposed tariff language consistent with *NUI* and Order No. 637.[28]

40. Southern further proposes on Third Revised Sheet No. 161 to establish a 15-day period as a deadline for the number of days within which a shipper may respond to Southern in the event that Southern does not receive any bids for a shipper's capacity. The currently-effective provision in section 20 of Southern's GT&C provides no limitation on the number of days for a shipper to respond. The Commission previously has approved a 20-business day limitation to the number of days for shippers

[27] *Id.* at 62,488 (footnotes omitted).

[28] *NUI Corp. v. Florida Gas Transmission Co.*, 92 FERC ¶ 61,044 at 61,121 (2000); *Regulation of Short-Term Natural Gas Transportation Services and Regulation of Interstate Natural Gas Transportation Services*, Order No. 637, FERC Stats. & Regs. (July 1996 - December 2000) ¶ 31,091 at 31,337, 31,341 (February 9, 2000). *See, e.g., Columbia Gas Transmission Corp.*, 107 FERC ¶ 61,078 at P 14 (2004).

to respond in *Columbia Gas*.[29] Even though the Commission has approved the use of a 20-day deadline for shippers to respond in the event no bids are received for a shipper's capacity, the Commission will accept Southern's proposed tariff revision.

41. The use of a 15-day period is internally consistent with the currently-effective tariff language in section 20 of the GT&C, which specifically provides for a 15-day period for a shipper to respond to bids that are received on the capacity in order to continue firm service. The Commission finds no reason to have a different number of days for shippers to respond to Southern when there are requests to continue service vis-à-vis when there are not. Moreover, the protestors have not shown that 15-days is an insufficient period to respond. However, the Commission will require Southern to revise the language to clarify that Southern and a shipper may mutually agree, on a not unduly discriminatory basis, to extend the now-approved 15-day period to facilitate negotiations consistent with *Columbia Gas*.[30]

42. In addition, Southern proposes to specify on Third Revised Sheet No. 161 that a shipper may elect to exercise its ROFR rights when the shipper gives Southern a voluntary notice of termination, but absent such an election, the agreement will be subject to pregranted abandonment.

43. In *Texas Eastern*,[31] the Commission stated that a shipper would provide notice to the pipeline stating whether or not it was interested in renewing its contract a reasonable period before the contract ends, normally six months to a year. At that juncture, the shipper would not have to make a final decision. If the shipper expressed any interest in renewing the contract, the pipeline would solicit third party offers for the capacity and then give the shipper the opportunity to match the offers. However, if a shipper voluntarily notified the pipeline that it no longer needed a volumetric portion of its capacity at the expiration of its contract, the shipper would not retain ROFR protection

[29] *Columbia Gas Transmission Corp.*, 107 FERC ¶ 61,078 at P 6 (2004) (*citing Pan-Alberta (U.S) Inc. v. Northern Border Pipeline Co.*, 101 FERC ¶ 61,249 (2002), *order on compliance filing*, *Northern Border Pipeline Co.*, 102 FERC ¶ 61,158 (2003) (*Northern Border*)).

[30] *Columbia Gas Transmission Corp.*, 107 FERC ¶ 61,078 (2004).

[31] *Texas Eastern Transmission, LP*, 101 FERC ¶ 61,215 (2002).

for that volumetric portion. The shipper would continue to have ROFR rights for that portion of its capacity that it retained, and the pipeline would have pregranted abandonment authority for the portion that the shipper terminated.

44. Further, in *GTN*,[32] the Commission stated that, if a shipper is certain it has no further interest in renewing its contract and chooses to forego its ROFR protection, the pipeline is free to market its capacity, and the tariff still provides a shipper with ROFR protection if it does not elect to terminate its contract.

45. As Municipals point out, the currently-effective section 20 of Southern's GT&C already provides a procedure whereby, if shipper gives notice to terminate the firm service agreement pursuant to the provisions contained therein, said agreement shall be subject to pregranted abandonment on the effective date of shipper's termination notice. Southern's proposed clarifying tariff revisions merely implement the Commission's policy to permit shippers to have the ability to exercise ROFR rights when the shipper terminates a contract, and therefore, the Commission accepts the proposed tariff revision on Third Revised Sheet No. 161.

2. <u>Treatment of Discounts</u>

a. <u>Southern's Proposal</u>

46. Southern also proposes to change section 42 of the GT&C, which describes the circumstances under which it may provide a discount that will not be considered a material deviation from the terms of its tariff.[33] Southern proposes to add two additional situations on Second Revised Sheet No. 212J in which discounted rates may be provided under a service agreement without the necessity of filing the agreement with the Commission.

47. According to Southern, the first category applies to a discount for certain quantities where the discount is conditioned upon completion of a construction project or acquisition of facilities. Southern states that this provision will allow it to provide a discount to a shipper only if the construction project to serve the market for which the

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[32] *Gas Transmission Northwest Corp.*, 107 FERC ¶ 61,253 at P 8 (2004).

[33] Southern cites *Natural Gas Pipeline Company of America,* 82 FERC ¶ 61,298 (1998); *Southern Natural Gas Co*., 86 FERC ¶ 61,317 (1999).

discount is provided is completed. However, Southern states that if the construction project is delayed or not completed, the shipper would pay the rate applicable to its existing service, and Southern would not be required to permit the discount.

48. Southern also explains that the second category allows adjustment of the rate components to preserve an agreed-upon overall effective rate so long as all rate components remain within the minimum and maximum rates. Southern asserts that, in such a situation, the discounted rate could be adjusted based on a revenue formula or application of an inflation factor so long as each of the rate components does not exceed the maximum rates set forth in the tariff.

49. Southern contends that these types of discount categories are similar to those previously approved by the Commission.[34] Southern claims that it modeled its discount language on language accepted by the Commission in *Great Lakes*.[35] Southern argues that the additional discount options will allow it more flexibility in its discount negotiations and provide more security for the parties with respect to the structure of their long-term agreements.

b. <u>Protests</u>

50. Atlanta and Chattanooga state that the Commission should require Southern to clarify its tariff to state that all discounted rate components must be identified and that any discount rate must produce a reservation rate per unit of contract demand. Peoples requests that this issue be addressed at a hearing.

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[34] Southern cites *Northern Natural Gas Co*., 105 FERC ¶ 61,299 (2003) and Letter Order dated April 30, 2004, in Docket No. RP00-152-004; *Northern Border Pipeline Co*., 107 FERC ¶ 61,005 (2004); *Panhandle Eastern Pipe Line Company, LLC*, 106 FERC ¶ 61,194 (2004); *CenterPoint Energy Gas Transmission*, 105 FERC ¶ 61,298 (2003) and Letter Order dated February 6, 2004, in Docket No. RP03-591-002; *Great Lakes Gas Transmission, LP* (*Great Lakes*), Letter Order dated June 22, 2004, in Docket No. RP04-318-000, *Overthrust Pipeline Co*., Letter Order dated July 15, 2003, in Docket No. RP03-528-000; *Questar Pipeline Co*., 103 FERC ¶ 61,244 (2003); *ANR Pipeline Co*., 85 FERC ¶ 61,333 (1998).

[35] *Great Lakes Gas Transmission, LP*, Letter Order dated June 22, 2004, in Docket No. RP04-318-000.

c. Commission Analysis

51. Southern states that the second category it proposes to add to section 42 of the GT&C states that, such discounted rate may provide for an agreed upon overall rate, with a provision for adjusting the rate components of discounted agreements, if needed to preserve the agreed upon overall effective rate, so long as all rate components remain within the applicable minimum and maximum rates specified in the tariff. However, Southern also states in the nature, reasons, and basis for the filing that the discounted rate could be adjusted based on a revenue formula or application of an inflation factor so long as each of the rate components does not exceed the maximum rates set forth in Southern's tariff.

52. The Commission accepts Southern's proposed tariff revisions on Second Revised Sheet No. 212J, subject to Southern providing an explanation that clarifies whether the discounted rates can be based on indices or basis differentials. If so, Southern must make additional tariff changes consistent with the Commission's order in *Northern Natural,*[36] to provide that such discounted rate (1) will use the same rate design as the pipeline's tariff rates, (2) will identify in the agreement what rate component is discounted (i.e., firm reservation charge or usage charge or both), and (3) to the extent the firm reservation charge is discounted, will produce a reservation rate per unit of contract demand if arrived at by formula.

3. Compliance with Orders of State Commissions

a. Southern's Proposal

53. Southern states that section 39 of the GT&C provides that a local distribution company (LDC) or Hinshaw pipeline may reduce its firm transportation quantities on Southern's system as a result of a final order from a state regulatory commission requiring the shipper to make such reduction. However, explains Southern, in such a case, the shipper must have furnished prior notice of the proceeding to Southern to allow Southern the opportunity to participate in the proceeding, and the shipper must have made a good faith effort to defend its existing firm quantities in the proceeding.

54. Southern explains that section 39 currently provides that the premature reduction shall become effective 90 days after the date of written notice to Southern. Southern states that it seeks to change the effective date of any such reduction to 24 months on Fourth Revised Sheet No. 212G. While Southern states that it is agreeable to

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[36] *Northern Natural Gas Co.*, 105 FERC ¶ 61,299 at P 20 (2003).

retaining the current section 39 for LDC's that are subject to state agency actions, it expresses concern that the existing notice period does not leave Southern enough time to respond to the action in order to mitigate the effects of the turned-back capacity.[37] Southern argues that it and the other customers on the system should not have to bear all the risk of the early turn-back, and by changing the effective date to 24 months, Southern will have time to hold an open season, which could allow it to either remarket the capacity or use it in conjunction with a system expansion.

b. <u>Protests</u>

55. Atlanta and Chattanooga ask the Commission to reject the tariff revision to the notice period for contract demand reductions ordered by a state commission. Atlanta and Chattanooga state that Southern has offered no evidence to support its claim that an extension of the notice period is needed to mitigate the effects of turned back capacity, and that Southern has not attempted to explain the impact of the proposed revision on firm and interruptible customers. Atlanta and Chattanooga claim that extending the notice period to 24 months from 90 days would undermine the purpose of the contract demand option and upset the balance of risk that Southern negotiated with its customers when it established the program as part of the settlement in its Order No. 636 compliance filing. Atlanta and Chattanooga state the proposal would shift virtually all the risk of exercising the reduction option to the shipper.

56. Southern Cities object to Southern's exclusion of self-governing municipal entities, such as Southern Cities, from contract demand reduction rights. Southern Cities state that these rights must be extended to all LDCs even if not state-regulated.[38] Shell LNG argues the proposed change may have adverse competitive effects and should be investigated at a hearing. Peoples also claims that the proposal is not just and reasonable.

c. <u>Commission Analysis</u>

57. Given the magnitude of the proposed increase to the notice period, the Commission concludes this issue should be addressed at the technical conference established by this order.

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[37] Southern cites *Columbia Gulf Transmission Co*., 105 FERC ¶ 61,351 (2003) (recognizing at P 11 that the Commission does not require pipelines to permit customers to make such reductions before the end of their contract terms).

[38] Southern Cities cite *Trunkline Gas Co., LLC*, 108 FERC ¶ 61,224 (2004); *Panhandle Eastern Pipe Line Co.*, 108 FERC ¶ 61,225 (2004).

4. Award of Receipt and Delivery Point Capacity

a. Southern's Proposal

58. Southern states that section 2.1(e) of the GT&C describes the rights of firm shippers to add or delete their firm receipt and delivery points. According to Southern, it recently revised its tariff to replace its current mechanism of awarding primary receipt point capacity from a first-come, first-served methodology to a net present value (NPV) allocation mechanism, consistent with the manner in which Southern awards pipeline capacity and delivery point capacity.[39] To further the consistency between the award of delivery point and receipt point capacity, Southern proposes to revise section 2.1(e) on Third Revised Sheet No. 103 to specify that primary receipt points may be added or deleted from Exhibit A to the service agreement if they are in the same zones for which the shipper has contracted for firm service. Similarly, continues Southern, shippers will be permitted to add or delete primary delivery points from Exhibit B to a service agreement only if the additional delivery points are in the same zone as the shipper's current delivery points. Southern states that this new provision does not specify a shipper's rights to deliver or receive gas from secondary delivery or receipt points, and it is not intended to define when a replacement shipper may select primary point rights.

b. Protests

59. Municipals argue that the Commission should reject Southern's proposed change to section 2.1(e) of the GT&C. Municipals claim that Southern's summary rationale is inadequate to support its proposal in the face of longstanding Commission policy and precedent that firm shippers should be given as much flexibility as operationally feasible. Southern Cities also argue there is virtually no justification for the revision to section 2.1(e) of Southern's GT&C to amend Exhibit A to an FT service agreement to add primary receipt points only to the extent new or increased points are in the same zone as those being deleted or adjusted downward from that same Exhibit A. Southern Cities assert that this tariff issue should be considered in the technical conference.

60. Calhoun argues that it is not clear why Southern has chosen to restrict the right to change primary receipt and delivery points for shippers that are not replacement shippers. Calhoun asserts that a pipeline must provide flexible rights to designate new primary points not only to shippers that have received released capacity, but also to shippers that are segmenting and utilizing their own capacity. Additionally, as long as the shipper is

[39] Southern cites *Southern Natural Gas Co.*, 104 FERC ¶ 61,333 (2003).

willing to pay the additional zone rate for moving to a new rate zone and the capacity is operationally available, Calhoun contends that there should be no restriction on a shipper moving to a new primary receipt or delivery point in a new zone.

61. Finally, Shell LNG contends that the proposed changes to section 2.1(e) of the GT&C may inhibit Zone 1 and Zone 2 customers from adding the Elba Island LNG terminal as a primary receipt point on their contracts and should be investigated at a hearing. Peoples also seeks a hearing.

c. <u>Commission Analysis</u>

62. The Commission concludes that this matter also should be addressed at the technical conference.

5. <u>Cash Out Calculation and SCRM</u>

a. <u>Southern's Proposal</u>

63. Southern proposes to change its cash out price calculation and the application of its existing SCRM. Southern explains that the changes to its cash out price include the addition of two prices under the existing indices, which reflect the index price of gas at the beginning of the month succeeding the month in which a shipper's imbalance accrues and the application of a high/low methodology instead of an average index price methodology to determine the cash out price, including for the first tier of majority shippers' imbalances between zero and two percent.

64. According to Southern, the Commission has approved the addition of the first week of the succeeding month indices in *Transco*,[40] finding that addition of the "fifth week" to Transco's pricing mechanism would assist in reducing arbitrage opportunities.[41] Southern also contends that its proposal to include a new high/low pricing structure for those shippers that are on the majority side of the system-wide imbalances and whose imbalances are between zero and two percent of the net imbalance percentage is comparable to the high/low pricing structure that was approved by the Commission

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[40] *Transcontinental Gas Pipe Line Corp.* 96 FERC ¶ 61,352 (2001), *order on reh'g*, 98 FERC ¶ 61,213 (2002) (*Transco*).

[41] *Transcontinental Gas Pipe Line Corp.*, 98 FERC ¶ 61,213 at 61,814 (2002).

in *Northern Natural*.[42] Specifically, contends Southern, in that case, the Commission found that application of the high/low price in the non-penalty range of cash out tolerance levels was not a penalty and was appropriate to reduce the incentives for arbitrage on the system.[43]

65. Southern asserts that both of the proposed modifications to its cash out pricing methodology are consistent with the Commission's recognition in Order No. 637 that pipelines' tariffs should be modified where the cash out mechanism provides opportunities for arbitrage and under-recovery of costs.[44] Southern further states that these proposed modifications also are consistent with the Commission's Order on Rehearing in Southern's most recent SCRM proceeding, in which the Commission declined to take action under NGA section 5 to require Southern to change its cash out pricing methodology, but strongly encouraged Southern to proceed with a filing under NGA section 4 to reduce gaming opportunities on its system once the rate moratorium prescribed in the Stipulation and Agreement expired.[45] According to Southern, the Commission also advised Southern to address the exclusion of poolers from the SCRM and to explain the relationship between its cash out mechanism and the SCRM. Therefore, Southern proposes to enlarge the application of the SCRM to its Supply Pool Balancing Agreement for receipt volumes that are nominated into pools from sources other than Rate Schedule CSS or ISS contracts, other Supply Pool Balancing Agreements, and Rate Schedule PAL points of transaction.

66. Southern proposes to change the calculation of Transportation Volumes under the SCRM to include pooling receipts in section 14.2 of the GT&C. According to Southern, under the SCRM, the Transportation Volume, which is divided into the amount incurred for a year under the SCRM account, previously only included deliveries of gas under Southern's FT, FT-NN, and IT rate schedules. Southern contends that inclusion of pooling volumes and application of the SCRM surcharge to poolers will increase the number of shippers that incur the SCRM, but it will also spread the cost of the SCRM more equitably by (1)

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[42] *Northern Natural Gas Co*. (105 FERC ¶ 61,172 (2003) (*citing Texas Gas Transmission Corp*., 97 FERC ¶ 61,349 at 61,333 (2001), *order on reh'g*, 107 FERC ¶ 61,252 (2004)).

[43] *Id.* at 61,889 (2003).

[44] Southern cites *Texas Gas Transmission Corp.*, 96 FERC ¶ 61,318 at p. 62,218 (2001), *order on reh'g*, 97 FERC ¶ 61,349 (2001) (*Texas Gas*).

[45] Southern cites *Southern Natural Gas Co*., 107 FERC ¶ 61,245 (2004).

applying it to a larger group of shippers, thereby minimizing the cost to each shipper, and (2) ensuring that it applies to all groups of shippers that incur imbalances and create the costs that are passed through the SCRM. Southern points out that it has filed the tariff changes to the SCRM surcharge on pro forma tariff sheets, requesting that it be allowed to place these sheets into effect on a prospective basis once an order on the merits or settlement of this proceeding has been issued.

b. Protests

i. Opposing

67. Indicated Shippers claim that the proposed imbalance cash out mechanism violates Commission policy set forth in Order No. 637 because it would penalize imbalances that have little or no impact on system reliability and unreasonably eliminate a penalty-free imbalance. Indicated Shippers state that, in Order No. 637, the Commission held that penalties may be used only to the extent necessary to prevent impairment of reliable service.[46] Indicated Shippers state that the Commission also found that stricter imbalance tolerances and higher penalties would operate to limit and distort market forces.[47] In Order Nos. 637 and 637-A, state Indicated Shippers, the Commission specifically criticized the pipelines' typical response of escalating tolerances and imbalances as a response to arbitrage.[48]

68. Indicated Shippers also claim that the Commission has held that penalties should not be more punitive than necessary to control system imbalances and should not eliminate flexibility.[49] Further, state Indicated Shippers, the Commission has recognized that some level of shipper imbalances is inevitable, in part because of a lack of real-time

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[46] Indicated Shippers cite *Texas Eastern Transmission Co.*, 97 FERC ¶ 61,349 at 62,633 (2001).

[47] Indicated Shippers cite Order No. 637, FERC Stats. & Regs., Regulations Preambles (July 1996 December 2000) ¶ 31,091 at 31,308, 31,314 (2002).

[48] Indicated Shippers cite *Texas Eastern Transmission, LP*, 102 FERC ¶ 61,198 at 61,570 (2003).

[49] Indicated Shippers cite Order No. 637, FERC Stats. & Regs., ¶ 31,091 at 31,314.

information, and that these should not be penalized.[50] Finally, Indicated Shippers state that Southern's meter error is set at two percent, which means that a shipper would pay a penalty for holding an imbalance, even when the imbalance is less than Southern's meter error.

69. Indicated Shippers state, that without a penalty-free tolerance zone, Southern's proposed changes to the imbalance cash out mechanism are more punitive than necessary to control system imbalances and violate the Commission's Order No. 637 policy with respect to penalties. As such, Indicated Shippers assert that Southern's proposal would result in unjust and unreasonable penalties for shippers who are managing their imbalances within a zone that is penalty free on most similar pipelines. Indicated Shippers aver that Southern's reliance on the *Northern Natural* decision[51] is inapposite, because it is anomalous as the exception to the rule and is pending judicial review.

70. Indicated Shippers explain that pools on Southern's system, are paper pools as they are on most pipelines, meaning that they do not involve the actual physical transportation of gas to, from, or within the pools, and are merely an administrative supply aggregation service. As such, continues Indicated Shippers, the pooling parties are not required to have transportation agreements on Southern's system in order to use the pools, but they do have pooling agreements.

71. Indicated Shippers assert that Southern has not provided any explanation of how pooling works on its system, how imbalances are created on the pools, how such pool imbalances are resolved as between pooler, producer, shipper and/or Southern, whether poolers have access to other services to cure imbalances, and how pool imbalances detrimentally impact system operations. Indicated Shippers also allege there is no linkage between pool imbalances and the SCRM account.

72. Indicated Shippers state that Southern has not provided the underlying data supporting its claim that, during the base period, the imbalances allocated to Supply Pool Balancing Agreements constituted 47 percent of the total imbalances accrued on an

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[50] Indicated Shippers cite *Texas Eastern Transmission Co. [sic]*, 81 FERC ¶ 61,118 at 61,420 (1997).

[51] *Northern Natural Gas Co.*, 105 FERC ¶ 61,172 (2003), *order denying reh'g*, 107 FERC ¶ 61,252 (2004), *appeal pending sub nom. The Industrials v. FERC*, Case Nos. 04-1250, *et al*. (D.C. Cir. filed July 29, 2004).

absolute volume basis, and that in nine out of the 12 months, the direction of the net imbalances accrued under the Supply Pool Balancing Agreements followed the direction of the arbitrage opportunities.

73. Indicated Shippers also state that Southern's proposal to charge the SCRM surcharge to poolers would likely have the effect of limiting the use of pools and hindering the development of market centers in direct contravention of the Commission's policy. Indicated Shippers state that, if the Commission were to approve Southern's proposal to assess the SCRM surcharge on poolers, suppliers would have less incentive to pool their gas on Southern's system, potentially reducing competition and gas supply on Southern's system.

74. Calhoun argues that the proposed cash out provisions should be rejected because Southern has not demonstrated current system reliability concerns that warrant implementation of new penalty structures and levels. Calhoun claims the Commission has determined that penalties must be limited to only those transportation situations that are necessary and appropriate to protect against system reliability problems.[52] Furthermore, Calhoun states that the Commission said that pipelines cannot impose penalties for other purposes, such as the enforcement of contractual obligations, where unrelated to system reliability.[53] As a result, states Calhoun, the Commission has rejected penalty structures that are not narrowly tailored to protect system operations.[54]

75. Sequent disagrees with Southern's assertions that the proposed changes in cash out pricing will eliminate or minimize gaming and the opportunity for price arbitrage on Southern's system. Sequent claims Southern has failed to demonstrate why the Commission should accept the proposed changes and has not presented evidence of harm to the Southern system resulting from imbalances.[55] Therefore, Sequent asks the Commission to set the issue for hearing.

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[52] Calhoun cites Order No. 637 at 31,314.

[53] Calhoun cites Order No. 637-A at 31,608.

[54] Calhoun cites *Transcontinental Gas Pipe Line Corp.*, 91 FERC ¶ 61,004 at 61,019-20, *order on reh'g*, 91 FERC ¶ 61,282 (2000).

[55] *Southern Natural Gas Co.*, 106 FERC ¶ 61,149 at P 19 (2004).

76. DETM and DEMA ask the Commission to reject Southern's proposed revisions to the cash out mechanism and SCRM or set the issues for hearing. With respect to the elimination of the no-penalty tier, DETM and DEMA note that Southern has not demonstrated that arbitrage is occurring, and that *Northern Natural*,[56] cited by Southern, is pending appeal in the courts. DETM and DEMA allege that case is contrary to every prior Commission order on the subject of high/low pricing and tolerance levels. Moreover, DETM and DEMA claim that Southern has experienced dramatic reductions in its balancing costs, and because the SCRM surcharge is very small, Southern's proposal amounts to overkill. Further, DETM and DEMA claim that pooling does not create physical imbalances, so that applying the SCRM to pooling will discourage the use of pools, and that shippers relying on pooled receipts will end up paying Southern's SCRM surcharge many times.

77. Southern Cities take no position with respect to the addition of two future pricing points to the monthly cash out formula; however, Southern Cities object to Southern's departing from the status quo to determine the cash out price for net monthly imbalances within two percent of the cumulative scheduled amount, and Southern Cities request that the issue be set for a technical conference.

ii. <u>Supporting</u>

78. Alabama Gas supports Southern's proposed tariff change in the cash out price calculation in section 14.1 of the GT&C and urges the Commission to accept the cash out pricing changes unconditionally effective October 1, 2004. Alabama Gas states that Southern has incurred large losses as a forced buyer and seller of natural gas under its cash out obligations, which have been caused by the ability of cash out parties to arbitrage the monthly cash out price. Additionally, Alabama Gas claims that Southern has passed through the losses as a surcharge applicable only to transportation customers, although the losses were generated by the cash out activities of transportation customers and supply poolers. Alabama Gas asserts that the proposed changes in method of determining cash out price are fully in accord with Commission policy and the Commission should summarily affirm the changes.

79. Alabama Gas also supports Southern's request that the Commission approve the extension of the SCRM to supply poolers that participate in cashing out imbalances on the Southern system. Alabama Gas points out that Southern has determined that approximately 47 percent of the total imbalances on the system are created by supply poolers, and they are a factor in the total pool of majority imbalances. Alabama Gas

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[56] *Northern Natural Gas Co.*, 105 FERC ¶ 61,172 (2003).

contends that, under these circumstances, supply poolers should be included in the SCRM and Southern should recover the surcharge over supply pooler volumes, as well as transportation customer throughput. Alabama Gas requests that the Commission act expeditiously so that the change can take effect with the SCRM, which will become effective on January 1, 2005.

80. Atlanta and Chattanooga support the proposed tariff revisions to the cash out calculation mechanism because the proposed revisions to the cash out mechanism will reduce arbitrage, and the proposed revisions to the SCRM will result in a more equitable distribution of SCRM costs. GIG states that the Commission needs more information and analysis relating to Southern's proposed tariff language changes and particularly the SCRM, but generally believes that it is important that Southern reduce opportunities for arbitrage on its system.

81. Municipals ask the Commission to accept Southern's proposed changes to the cash out tariff provisions and the SCRM pro forma tariff provisions. Alternatively, the Municipals argue that Commission should suspend the pro forma tariff sheets for one day and convene a technical conference to resolve any issues relating to these proposals. Municipals state that, if the Commission does not grant the requested summary revisions or rejections to sections 2 and 20 of the GT&C, then the Commission should suspend the tariff sheets for five months and convene a technical conference relating to these proposals.

82. Municipals request that the Commission implement Southern's cash out mechanism tariff changes to stop opportunities for gaming on Southern's system. Municipals assert that the Commission should also accept the proposed changes to the SCRM to make the SCRM charge applicable to poolers because they are the principal cause of the surcharge. Municipals state that poolers are a significant percent of the imbalances that create the need for cash out activity. Municipals claim that subjecting poolers to the SCRM surcharge will provide the incentive to minimize cash out activities, including those whose purpose and effect are to price arbitrage.

83. Southern LDCs filed an answer to the protests of Indicated Shippers, Calhoun, and Sequent. Southern LDCs aver that Southern's proposed changes to section 14.1 are fully consistent with Commission precedent that the Commission will adopt changes to a pipeline's cash out pricing provisions to stop the opportunity for gaming. Southern LDCs

claim that the specific changes that are being challenged – the use of high/low indexes relating to the month of imbalances as well as the following month – were approved by the Commission in *Northern Natural*.[57]

84. Southern LDCs claim that Sequent distorts the meaning of *Southern*.[58] In that order, state Southern LDCs, the Commission ruled that Southern was precluded by a prior settlement's rate moratorium provision from proposing NGA section 4 changes to its cash out pricing provision, and thus that the Commission could only act under NGA section 5. Moreover, continue Southern LDCs, the Commission ruled that it would impose such changes to Southern's cash out provisions under NGA section 5 under "extraordinary conditions," which were not demonstrated in that proceeding.

85. Southern LDCs indicate that the Commission has repeatedly rejected the position that revisions to existing cash out provisions must be justified by showing that price arbitrage has actually occurred,[59] instead ruling that it was sufficient that existing provisions gave rise to the possibility of arbitrage. Southern LDCs claim that the protestors have not attempted to challenge the substantial showing in the rate filing that the proposed revisions are required to stop the opportunity for price arbitrage.

86. Southern LDCs claim that Calhoun's argument that the Commission requires a showing of operational problems before it can change cash out pricing provisions was expressly rejected in *Texas Gas*.[60]

87. Southern LDCs note that Indicated Shippers argue against the proposed changes which would eliminate a penalty-free zone of zero to two percent for imbalances. Nevertheless, Southern LDCs point out that the Commission has approved revisions in the cash out price index for imbalances in the penalty-free zone to eliminate the

[57] Southern LDCs cite *Northern Natural Gas Co.*, 105 FERC ¶ 61,172 at 61,889 (2003), *reh'g denied*, 107 FERC ¶ 61,252 (2004).

[58] Sequent cites *Southern Natural Gas Co.*, 106 FERC ¶ 61,149 (2004).

[59] Southern LDCs cite *Transcontinental Gas Pipe Line Corp.*, 98 FERC ¶ 61,213 at 61,814 (2002); *Gulf South Pipeline Co.*, 98 FERC ¶ 61,068 at 61,180 (2002).

[60] *Northern Natural Gas Co.*, 105 FERC ¶ 61,172 at P80 (2003) (*citing Texas Gas Transmission Corp.*, 97 FERC ¶ 61,349 (2001)).

opportunity for arbitrage.[61] Southern LDCs assert that the Commission rejected Indicated Shippers argument that changes to Northern Natural's cash out provisions, which Indicated Shippers claim are substantially equivalent to those Southern proposes, could not be made because they would violate the notion of a penalty-free zone.

c. Commission Analysis

88. A pipeline has the initiative under NGA section 4 to propose rates, terms, and conditions for the services it provides.[62] If the pipeline shows that its proposal is just and reasonable, the Commission must accept it, regardless of whether other rates, terms and conditions must be just and reasonable.[63] Here Southern, with one exception, generally shows that its use of a high/low index price methodology for all imbalance tiers using five weeks data is just and reasonable and consistent with Commission precedent.[64]

89. In its NGA section 4 filing, Southern asserts that the proposed changes are needed to minimize gaming and arbitrage because there is evidence (1) that the vast majority of imbalances that are cashed out on Southern's system occur in the zero to two percent tier where the average index price is applied today, (2) that under the currently-effective cash out mechanism, shippers typically are able to determine the average index price with certainty before the end of the month, and (3) that the direction of the net imbalances on the system typically tracks the direction of the market price changes during the month as compared to the average index price.[65] Moreover, Southern states that shippers are only required to use cash out pricing if they do not resolve their net monthly imbalances by using the many imbalance management tools offered under Southern's tariff to resolve imbalances on Southern's system.

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[61] Southern LDCs cite *Guardian Pipeline Co.*, 102 FERC ¶ 61,081 at 61,223 (2003); *Transcontinental Gas Pipe Line Corp.*, 96 FERC ¶ 61,352 at 63,311-13 (2001); *Northern Natural Gas Co.,* 105 FERC ¶ 61,172 (2003).

[62] *United Gas Pipe Line Co., v. Mobile Gas Service Corp*., 350 U.S. 332 (1956); *ANR Pipeline Co. v. FERC*, 771 F.2d 507, 513 (D.C. Cir. 1985).

[63] *Western Resources, Inc. v. FERC*, 9 F.3d 1568, 1578 (D.C. Cir. 1993).

[64] The Commission has previously declined to modify Southern's cash out mechanism to adopt a five-week structure and high/low index price under NGA section 5. *See Southern Natural Gas Co.*, 106 FERC ¶ 61,149 at P 18 (2004), *order on reh'g*, 107 FERC ¶ 61,245 (2004).

[65] *See* Prepared Direct Testimony of Ms. Janice H. Parker.

90. Under the currently-effective mechanism, as explained by Southern, shippers can predict toward the end of the month with reasonable accuracy whether the cash out prices are above or below market prices. By contrast, under the high/low weekly system, with the addition of a fifth-week, Southern anticipates it can deter price arbitrage by injecting uncertainty into the cash out price so that a party trying to game the system cannot reasonably predict the cash out price. Southern states that the uncertainty increases the risk and lowers the inclination to arbitrage.

91. The Commission accepts, to be effective October 1, 2004, Southern's proposal to cash out imbalances based on the weekly high/low price and to incorporate the five-week structure, subject to further consideration of two aspects of that proposal at the technical conference previously established in this order.[66] In *Northern Natural*,[67] the Commission stated that it regularly approves pipelines' requests to cash out at a weekly high/low index price as a means to discourage arbitrage. For example, in *Texas Gas,*[68] the Commission approved a similar provision recognizing that use of the weekly high/low price better balances the goals of deterring arbitrage, while not imposing an unnecessarily high penalty on the customers. In addition, the Commission has accepted the addition of a fifth-week to assist in reducing arbitrage opportunities.[69] Thus, the Commission generally approves Southern's use of a weekly high/low price and the addition of a fifth week.

92. However, the protesting parties have raised concerns that application of the high/low index price to the zero to two percent tolerance level would mean that a shipper would pay a penalty for holding an imbalance, even when the imbalance is less than Southern's meter error. In order to develop a more complete record on that issue, the Commission will include it in the issues to be addressed at the technical conference previously established in this order.

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[66] In *Southern Natural Gas Co*., 107 FERC ¶ 61,245 at P 8 (2004), the Commission stated that it expected Southern to file to modify its cash out provisions at the end of its rate moratorium in addition to reducing gaming opportunities on its system and to explain the relationship between its cash out mechanism and its SCRM.

[67] *Northern Natural Gas Co.*, 105 FERC ¶ 61,172 (2003), *order on reh'g*, 107 FERC ¶ 61,252 (2004).

[68] *Texas Gas Transmission Corp.*, 97 FERC ¶ 61,349 at 61,333 (2001).

[69] *Transcontinental Gas Pipe Line Corp*., 98 FERC ¶ 61,213 at 61,814 (2002).

93. The Commission also concludes that the pro forma changes to the SCRM in section 14.2 of the GT&C, under which the SCRM would be applied to poolers, should also be addressed at the technical conference.

Technical Conference

94. The Commission will direct the Staff to convene a technical conference to address certain proposed tariff sheets and the pro forma tariff sheets, as discussed above. Southern must be prepared at the technical conference to address the issues raised by the protests and to fully support its position on each issue. A technical conference is an informal, off-the-record conference at which the parties and the Staff can explore the issues raised by the proposed and pro forma tariff sheets, gain an understanding of the facts, and obtain additional information regarding the positions of the parties in order to facilitate a more prompt resolution of the issues. Following the conference, the parties will have an opportunity to file written comments that will be included in the formal record of the proceeding and, together with the record developed to date, will form the basis for further Commission action on the proposed and pro forma tariff sheets.

Suspension

95. Based on a review of the filing, the Commission finds that the proposed tariff sheets set for hearing and set for technical conference have not been shown to be just and reasonable and may be unjust, unreasonable, unduly discriminatory, or otherwise unlawful. Accordingly, the Commission shall accept the tariff sheets for filing and suspend their effectiveness for the periods set forth below, subject to the conditions set forth in this order.

96. The Commission's policy regarding rate suspensions is that rate filings generally should be suspended for the maximum period permitted by statute where preliminary study leads the Commission to believe that the filing may be unjust, unreasonable, or that it may be inconsistent with other statutory standards.[70] It is recognized, however, that shorter suspensions may be warranted in circumstances where suspension for the maximum period may lead to harsh and inequitable results.[71] Such circumstances do not exist here. Accordingly, the Commission will exercise its discretion to suspend the accepted tariff sheets listed in Appendix A for the maximum period and, with the

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[70] *Great Lakes Gas Transmission Co*., 12 FERC ¶ 61,293 (1980) (five-month suspension).

[71] *Valley Gas Transmission, Inc*., 12 FERC ¶ 61,197 (1980) (one-day suspension).

exception of tariff sheets set for technical conference, will permit the tariff sheets to take effect on March 1, 2005, subject to refund and subject to conditions established in the body of this order and in the ordering paragraphs below. As discussed above, the tariff sheets reflecting provisions set for technical conference are suspended until October 1, 2004, or the earlier of a date set by a subsequent Commission order, or March 1, 2005.

The Commission orders:

(A) As reflected in Appendix A, certain tariff sheets are accepted and suspended to be effective March 1, 2005, subject to refund and subject to the outcome of the hearing, as discussed in the body of this order.

(B) As further reflected in Appendix A, certain tariff sheets are accepted and suspended to be effective March 1, 2005, or earlier date set by subsequent Commission order, subject to refund and subject to the outcome of the technical conference, as discussed in the body of this order.

(C) As reflected in Appendix B, certain tariff sheets are accepted and suspended to be effective October 1, 2004, subject to refund and subject to the outcome of the technical conference, as discussed in the body of this order.

(D) Pursuant to the authority of the NGA, particularly sections 4, 5, 8, and 15 thereof, and the Commission's rules and regulations, a public hearing will be held in this proceeding concerning the lawfulness of Southern's proposed rates.

(E) A presiding administrative law judge, to be designated by the Chief Administrative Law Judge for that purpose, pursuant to 18 C.F.R. § 375.304 (2004) shall convene a prehearing conference in this proceeding, within 20 days of the date of this order, in a hearing or conference room of the Federal Energy Regulatory Commission, 888 First Street, N.E., Washington, D.C. 20426. The prehearing conference shall be held for the purpose of clarification of the positions of the participants and establishment by the presiding judge of any procedural dates necessary for the hearing. The presiding administrative law judge is authorized to conduct further proceedings pursuant to this order and to the Commission's Rules of Practice and Procedure.

(F) The Commission's Staff is hereby directed to convene a technical conference to explore the issues raised by Southern's proposed tariff revisions and pro forma tariff sheets that are set for technical conference, as discussed in the body of this order. The Staff must report the results of the technical conference to the Commission within 120 days of the date of issuance of this order.

(G) As reflected in Appendix B, certain tariff sheets are accepted for filing to become effective on October 1, 2004, as proposed, subject to conditions, as discussed in the body of this order. Southern is directed to file revised tariff sheets within 30 days of the date of issuance of this order to be effective October 1, 2004 to comply with the conditions discussed in the body of the order.

By the Commission.

(S E A L)

Linda Mitry,
Acting Secretary.

APPENDIX A

Southern Natural Gas Company
Docket No. RP04-523-000

Tariff Sheets Accepted for Filing, Suspended, Subject to Refund and Set for Hearing to Be Effective on March 1, 2005

<u>Seventh Revised Volume No. 1:</u>

Sixty-Fourth Revised Sheet No.14
Eighty-Fifth Revised Sheet No. 15
Sixty-Fourth Revised Sheet No. 16
Eighty-Fifth Revised Sheet No. 17
Forty-Eighth Revised Sheet No. 18
First Revised Fifth Revised Sheet No. 19*
Seventh Revised Sheet No. 20
Sixth Revised Sheet No. 21
Fifth Revised Sheet No. 25

*This tariff sheet should be paginated as Sixth Revised Sheet No. 19.

Tariff Sheets Accepted for Filing, Suspended, and Subject to Technical Conference to Be Effective on March 1, 2005, or Earlier Date Set by Subsequent Commission Order

<u>Seventh Revised Volume No. 1:</u>

Third Revised Sheet No. 103
Fourth Revised Sheet No. 212G

APPENDIX B

Southern Natural Gas Company
Docket No. RP04-523-000

Tariff Sheets Accepted for Filing to Be Effective October 1, 2004, Subject to Conditions

Seventh Revised Volume No. 1:

Ninth Revised Sheet No. 41
Ninth Revised Sheet No. 53
Sixth Revised Sheet No. 61
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Third Revised Sheet No. 159
Third Revised Sheet No. 160
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Tariff Sheets Accepted for Filing and Suspended to Be Effective October 1, 2004, Subject to Refund and the Outcome of the Technical Conference

Seventh Revised Volume No. 1:

Sixth Revised Sheet No. 140
Fourth Revised Sheet No. 140A
Fifth Revised Sheet No. 141
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