

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, D.C. 20426

February 22, 2006

In Reply Refer To:
Columbia Gas Transmission Corporation
Docket No. RP06-181-000

Columbia Gas Transmission Corporation
12801 Fair Lakes Parkway
Fairfax, Virginia 22033-3874

Attention: Thomas D. Stone
Manager, Rates and Tariffs

Reference: Revision to Penalty Provision

Ladies and Gentlemen:

1. On January 23, 2006, Columbia Gas Transmission Corporation (Columbia Gas) filed a revised tariff sheet¹ proposing to increase its imbalance penalty under Rate Schedule SIT (Storage in Transit) from \$0.25 per Dth to \$5.00 per Dth. The Commission rejects Columbia Gas' proposed tariff sheet for the reasons discussed below.

2. Notice of Columbia Gas' filing was issued January 26, 2006. Interventions and protests were due February 4, 2006, as provided in section 154.210 of the Commission's regulations (18 C.F.R. § 154.210 (2005)). United States Gypsum Company (U.S. Gypsum) and Virginia Power Energy Marketing, Inc. (Virginia Power) filed timely motions to intervene and protests. On February 6, 2006, Amerada Hess Corporation (Amerada Hess) filed a motion to intervene out of time and a protest, and Conectiv Energy Supply, Inc. (Conectiv) filed a motion to intervene out of time and comments. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2005), all timely motions to intervene and any motions to intervene out-of-time filed before the issuance date of this order are granted. Granting late intervention at this stage of the proceeding will not disrupt the proceeding or place additional burdens on existing parties. Columbia Gas filed an answer on February 14, 2006. Under Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 213(a)(2) (2005), answers to protests are not accepted unless otherwise ordered by the decisional authority. The Commission will accept Columbia Gas' answer because it further clarifies the issues.

¹ Fifth Revised Sheet No. 196 to FERC Gas Tariff, Second Revised Volume No. 1.

3. Section 2(b) of Columbia Gas' rate schedule SIT currently "provides for interruptible storage of gas to balance differences between actual receipts and actual deliveries under Shipper's Transportation Service Agreements." Under this rate schedule, SIT shippers are permitted to create imbalances, positive or negative, on the condition that twice during any 30-day period, the net SIT imbalance quantity is eliminated, or any negative SIT imbalance quantity is converted to a positive SIT imbalance quantity or vice versa, which Columbia Gas refers to as "cross-zero-twice." If the shipper fails to cross-zero-twice for each 30-day period, the shipper shall pay Columbia Gas a penalty of \$0.25 per Dth at the end of the 30-day period.

4. Columbia Gas states that SIT service is intended to allow shippers to manage imbalances caused by variations in their actual receipts and/or deliveries. Columbia Gas asserts that due to the recent spike in natural gas prices, the current SIT penalty has created unintended opportunities for shippers to realize financial gains which negatively affect its overall system operations. In its filing, Columbia Gas has submitted a hypothetical example showing how one shipper may have taken advantage of the existing SIT penalty to realize a potential financial gain totaling over \$4.2 million dollars during the time period from late September through December 31, 2005. Therefore, Columbia Gas states that it is necessary to increase its SIT penalty from \$.25 per Dth to \$5.00 per Dth to correct this type of behavior and preserve its system integrity.

5. Amerada Hess protests that the proposed penalty may be unjust and unreasonable and violates Commission policy regarding penalties because it is not narrowly designed and is unnecessary to protect system integrity. Amerada Hess asserts that Columbia Gas' tariff already provides it with the tools needed to protect system integrity by imposing an interruption order or an Operational Flow Order (OFO) on offending SIT shippers. Amerada Hess states that Columbia Gas failed to use these tools during the time period set forth in the hypothetical example and, since Columbia Gas failed to issue an interruption order or an OFO, Columbia Gas saw no need to preserve system integrity, which means that the proposed SIT penalty cannot be narrowly designed to deter conduct harmful to Columbia Gas' system.

6. Further, Amerada Hess states that Columbia Gas' hypothetical example is problematic for several reasons. Amerada Hess states that relationships or ties between the data shown in the hypothetical example, Columbia Gas' current SIT tariff language and its proposed increased SIT penalty are unclear. Amerada Hess states that Columbia Gas has no means of knowing the reasoning behind the shipper's flow activity or whether any profit was actually realized. Lastly, Amerada Hess states that the hypothetical example was based on one shipper's activities under discreet market conditions that cannot be replicated. Therefore, Amerada Hess requests that the Commission reject Columbia Gas' proposal.

7. Conectiv agrees with Columbia Gas that the proposed penalty provision will increase a SIT shipper's incentive to manage its SIT balances in a manner consistent with the intent of the SIT service. However, Conectiv argues that raising the SIT penalty does nothing to prevent arbitrage during a given 30-day period because a SIT shipper may withdraw or inject as much gas as it can for whatever business purpose, as long as the shipper crosses-zero-twice within the prescribed 30-day period. Conectiv requests

clarification of the hypothetical example to show how the SIT penalty is calculated based on Columbia Gas' existing tariff language. Conectiv requests further clarification on whether and how Columbia Gas could have used section 6 of Rate Schedule SIT and section 17 of its General Terms and Conditions which permits the use of an OFO to prevent a shipper from negatively impacting Columbia Gas' system operations.²

8. U.S. Gypsum objects to the filing stating that Rate Schedule SIT is for interruptible storage service and Columbia Gas' proposal would substantially increase penalties during non-critical periods inconsistent with Commission policy. Further, U.S. Gypsum states that Columbia Gas does not and cannot demonstrate that the proposed penalty increase will be narrowly applied to those who actually harm its pipeline system and will place a substantial burden on those shippers who cause no harm. Therefore, U.S. Gypsum requests that the Commission reject Columbia Gas' proposal because it is overly broad, excessive and contrary to Commission policy.

9. Virginia Power states that Columbia Gas' filing fails to demonstrate that the proposed penalty increase is appropriate or necessary to maintain system reliability. Virginia Power claims that Columbia Gas already has tariff provisions to discipline offending SIT shippers and did not use OFOs, which means system integrity was not threatened. Since Columbia Gas' proposal is not narrowly designed and closely related to conduct that would harm its system, Virginia Power requests that the Commission reject Columbia Gas' proposal.

10. In its answer, Columbia Gas states that U.S. Gypsum's claim that non-critical day penalties are contrary to Commission policy is erroneous. Columbia Gas asserts that U.S. Gypsum ignored the Commission' holding in Order No. 637-A and that the Commission has approved the imposition of penalties during non-critical periods on numerous occasions since Order No. 637.³

11. Columbia Gas states that Virginia Power and Amerada Hess have mischaracterized the facts regarding the need for the proposed penalty increase to effectively and efficiently manage its system. Columbia Gas states that the proposed penalty increase is clearly designed to prevent the impairment of reliable service in compliance with section 284.12(b)(2)(v) of the Commission's regulations, 18 C.F.R. § 284.12(b)(2)(v) (2005). Columbia Gas argues that a shipper alters the nature of SIT service when the shipper withdraws significant volumes of gas to use as a source of low

² See section 6 (Penalties) on proposed Fifth Revised Sheet No. 197 which describes the penalties that may be imposed on a shipper if it fails to comply with an interruption order or OFO issued by Columbia Gas.

³ *Regulation of Short-Term Natural Gas Transportation Services, and Regulation of Interstate Natural Gas Transportation Services*, Order No. 637, 1996-2000 FERC Stats. & Regs., Regs. Preambles ¶ 31,091, *order on reh'g*, Order No. 637-A 1996-2000 FERC Stats. & Regs., Regs. Preambles ¶ 31,099, *order on reh'g*, (Order No. 637-A), Order No. 637-B, 92 FERC ¶ 61,062 (2000), *aff'd in part and remanded in part*, *Interstate Natural Gas Assoc. of America v. FERC*, 285 F.3d 18 (D.C. Cir. 2002), *order on remand*, *American Gas Assoc. v. FERC*, 428 F.3d 255 (D.C. Cir. 2005).

cost loans which was only intended to provide incidental balancing. Columbia Gas states that these significant withdrawals could otherwise be used by Columbia Gas to manage total system obligations and that the withdrawals have a significant impact on its system operations and ability to provide reliable service. Therefore, Columbia Gas states that the proposed penalty increase will continue to keep shippers using the SIT rate schedule within its intended use.

12. Further, Columbia Gas states that Virginia Power's and Amerada Hess' claim that it has the ability to issue an OFO if a shipper's abuse threatens Columbia Gas' system integrity is directly at odds with the Commission's policy under Order No. 637. Columbia Gas states section 284.12(c)(2)(iv) of the Commission's regulations, 18 C.F.R. § 284.12(c)(2)(iv) (2005), provides that "a pipeline must take all reasonable actions to minimize the issuance and adverse impacts of operational flow orders (OFOs) or other measures taken to respond to adverse operational events on its system." Columbia Gas states that modifying the SIT rate schedule to respond to changing markets and to keep the service manageable and consistent with its intended purpose is preferable to "management by OFO." Columbia Gas states that pipelines are not required to wait until system integrity has been compromised to take action, but must have penalty provisions that are sufficient to prevent such damage from occurring.

13. Columbia Gas asserts that the proposed penalty increase is necessary to prevent shippers from altering the nature of SIT service, which may create unintended opportunities for shippers to realize financial gains, including arbitrage. Columbia Gas states that the Commission has recognized in Order No. 637-A that pipelines may need to "revise the level and structure of their penalty provisions to minimize the opportunities for arbitrage," and that the existing SIT penalty of \$0.25 per Dth provides too many opportunities for shippers to alter the SIT service in pursuit of financial gain. Further, Columbia Gas argues that continuing to impose a currently ineffective penalty for SIT service would be contrary to the Commission's Order No. 637 because SIT shippers may take advantage of the current "de minimis" penalty, thereby compromising the ability of other shippers to use SIT service for imbalance management as it was originally intended. Columbia Gas states that its proposal to increase the SIT penalty is consistent with Commission policies on preventing arbitrage and promoting the use of imbalance management services because it provides appropriate incentives to use SIT service for which it was designed.

14. In response to Conectiv, Columbia Gas clarifies that the SIT penalty is assessed on any undertendered or overtendered imbalance quantity in existence at the end of any 30-day period, and is not calculated on each day during the subject 30-day period. Columbia Gas states that it is not opposed to modifying section 3(b) of the SIT rate schedule to provide for a daily calculation. Columbia Gas states that the failure to interrupt and OFO penalties provided in section 6 of rate schedule SIT are authorized in addition to the penalties set forth in section 3, and these penalties are not redundant because they only apply when a critical day has been declared, whereas the failure to cross-zero-twice penalty applies during non-critical periods too. Columbia Gas states that to the extent a critical day was declared during the time period covered in the hypothetical example, it would have had the authority to interrupt the shipper or issue a shipper-specific OFO.

Lastly, Columbia Gas claims that the shipper in question was motivated to use the SIT service improperly by paying the \$0.25 Dth per day penalty and obtaining the arbitrage gain, which distorts the character of SIT service, instead of utilizing it for incidental balancing as it was originally designed.

15. The Commission finds that Columbia Gas' proposed SIT penalty may be assessed at any time that the cross-zero-twice conditions are not met as set forth in the SIT rate schedule. Columbia Gas' current SIT tariff provisions make no distinction between critical and non-critical periods and the penalty can be imposed at any time the rate schedule conditions are met. Therefore, Columbia Gas' proposal to increase the SIT penalty for non-critical periods is contrary to Commission policy and is rejected.⁴

16. In its answer Columbia Gas states that "the Commission has approved the imposition of penalties during non-critical periods on numerous occasions in the wake of Order No. 637," citing several cases.⁵ Columbia Gas is correct that the Commission has approved nominal penalties during non-critical time periods, but the Commission has only permitted pipelines to charge substantial penalties (1) during critical periods where the penalized conduct would impair system reliability,⁶ or (2) where necessary to prevent arbitrage that would cause the pipeline to underrecover its costs.⁷ Columbia Gas has not justified its proposed SIT penalty increase of \$5.00 per Dth under either ground. Columbia Gas has not shown that the conduct subject to the penalty necessarily threatens system reliability. In situations where a pipeline has a penalty for conduct that might, but will not necessarily, threaten system reliability, the Commission has required a pipeline to waive a penalty if the conduct does not in fact cause operational harm problems. Yet, Columbia Gas proposes to impose its \$5.00 penalty without regard to whether a shipper's failure to comply with the tariff conditions caused operational harm.

17. The Commission recognizes that it has permitted pipelines to tighten their cash-out mechanisms in order to discourage arbitrage without a showing that the arbitrage is causing operational harm.⁸ In those cases, the arbitrage was causing the pipeline to

⁴ See, e.g., *Dominion Transmission, Inc.*, 113 FERC ¶ 61,269 at P 10 (2005); *Paiute Pipeline Co.*, 109 FERC ¶ 61,139 at P 12 (2005).

⁵ E.g., *Dominion South Pipeline Co., L.P.*, 113 FERC ¶ 61,064 at P 39 (2005); *Williams Gas Pipelines Central, Inc.*, 100 FERC ¶ 61,232 at P 21-22 (2002); *Paiute Pipeline Co.*, 109 FERC ¶ 61,139 at P 12 (2005); *Northern Natural Gas Co.*, 101 FERC ¶ 61,203 at P 170 (2002); *MIGC, Inc.*, 96 FERC ¶ 61,042 at 61,107 (2001).

⁶ See, e.g., *Columbia Gas Transmission Corp.*, 113 FERC ¶ 61,191 at P 10 (2005).

⁷ See, e.g., *Northern Natural Gas Co.*, 105 FERC ¶ 61,172 (2003), *order on reh'g*, 107 FERC ¶ 61,252 (2004), *aff'd, Industrials v. FERC*, 426 F.3d 405 (D.C. Cir. 2005).

⁸ See, e.g. *Texas Gas Transmission Corp.*, 97 FERC ¶ 61,349 at 62,634-35 (2001) ("There is no reason to make the correction of such a problem contingent on a showing that the imbalances are causing operational problems.")

underrecover its costs, since, in the context of the cash-out mechanism, the arbitrage had the effect of requiring the pipeline to sell gas to its customers at below market levels and buy gas from them at above-market levels. The Commission accordingly held that it was “not just and reasonable to require pipelines to underrecover their costs, and . . . the Commission did not require such a thing in Order No. 637.”⁹ Here, Columbia Gas has made no showing that whatever arbitrage is occurring will cause it any financial loss. Thus, the Commission’s orders permitting pipelines to tighten their cash-out mechanisms to minimize arbitrage provide no support for Columbia Gas’ instant proposal.

18. The Commission also finds that existing language contained in section 6 of Columbia Gas’ SIT rate schedule permits Columbia Gas to take action by issuing an interruption order or OFO if it deems that system operations or integrity are threatened. Based on the information provided by Columbia Gas in its filing, Columbia Gas did not take these actions against the shipper during the time period set forth in the hypothetical example. Further, the Commission has insufficient information to determine whether the shipper actually arbitrated or caused harm to the integrity of Columbia Gas’ system. Therefore, Columbia Gas’ proposal fails because it has not shown how the increased SIT penalty proposal would be limited or narrowly designed to apply to only those shippers that actually harmed its system.¹⁰

By direction of the Commission.

Magalie R. Salas,
Secretary.

⁹ *Id.*

¹⁰ See, e.g., *Transcontinental Gas Pipe Line Corp.*, 98 FERC ¶ 61,366 (2002); *Algonquin Gas Transmission Co.*, 98 FERC ¶ 61,211 (2002).