UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Colorado Interstate Gas Co. Docket No. RP06-220-000

ORDER ACCEPTING TARIFF SHEETS

(Issued March 31, 2006)

1. On February 15, 2006, Colorado Interstate Gas Co. (CIG) filed in Docket No. RP06-220-000 revised tariff sheets proposing to alter its cash-out procedures to establish a high-low pricing methodology based on a proposed new cash-out system index price. CIG proposes that the tariff sheets become effective on April 1, 2006. In this order, the Commission accepts the revised tariff sheets effective April 1, 2006.

Background

2. CIG's filing proposes several changes to its cash-out procedures in order to reduce opportunities for price arbitrage. CIG is proposing to alter its current cash-out procedure, which currently employs a cash-out price derived by calculating the daily average of the prices during a four week period from two different published indices.

3. CIG's proposal includes a high-low methodology in which the average price is calculated based on weekly price averages over some period. Shippers who leave gas on the pipeline are paid the lowest average price for that excess gas, whereas shippers who take too much gas off the pipeline must pay for it at the highest average price. By implementing a high-low pricing methodology in which the cash-out price is based on the highest or lowest average weekly price within a five week period, CIG hopes to eliminate opportunities for price arbitrage. The use of an average weekly price combined with the addition of a fifth week in the cash-out period adds sufficient uncertainty as to what the cash-out price will be at the end of any given period. This uncertainty discourages shippers' attempts to predict and capitalize on the cash-out prices.

4. CIG also proposes to change the definition of the cash-out index price for everything except the index price used in its fuel recovery process. Currently, the cash-out index price is defined as the average of two daily mid-point index prices, Oklahoma – NGPL (Oklahoma) and the Rockies – CIG (Rockies) published in Platt's Gas Daily Price Guide. This index price would remain for CIG's fuel recovery process. However, for other cash-out purposes, CIG proposes to replace the Rockies index price with the Platt's Rockies – Cheyenne Hub (Cheyenne) index price because it is more indicative of CIG's purchases to replace gas owed by shippers through their imbalance activities.

5. Finally, CIG proposes to amend rate schedules PAL-1, HUB-1, APAL-1 and SS-1, which currently provide that loaned quantities of gas not returned within a specified period will be sold to the shipper (or in the case of SS-1, under-delivered gas not returned will be sold to the operator) at 150% of the cash-out index price. CIG proposes that these rate schedules also be updated to follow the cash-out index price described above.

Public Notice, Interventions and Protests

6. Public notice of the instant filing was issued on March 14, 2006, with interventions and protests due as provided for in the Commission's regulations. Pursuant to Rule 214 (18 C.F.R. § 154.210 (2005)), all timely filed 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. Indicated Shippers[1] protested the filing and CIG filed an answer on March 8, 2006. Under Rule 213(a)(2) of the Commission's Rules of Practice and Procedure,[2] answers to protests and replies to answers are not accepted unless otherwise ordered by the decisional authority. The Commission will accept CIG's answer because it provided information that assisted in our decision-making process.

7. The Indicated Shippers protest that CIG has not justified substitution of the Cheyenne index for the Rockies index in calculation the cash-out price and unreturned gas price; that CIG has not justified adoption of high-low pricing for the same; that a penalty credit should encompass penalties paid by Operational Balancing Agreement (OBA) parties; and that OBA parties should be included among the parties that receive the penalty credit.

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[1] The Indicated Shippers are BP Energy Co., BP America Production Co., Chevron Natural Gas, a division of Chevron U.S.A. Inc., and Marathon Oil Corp.

[2] 18 C.F.R. § 385.213(a)(2) (2005).

8. The Indicated Shippers argue that Cheyenne is not an appropriate cash-out pricing location for several reasons. First, CIG is not justified in switching the index location because CIG has not supported its assertions that it purchases more operational gas at Cheyenne than at the Rockies location. Second, the Rockies index is more liquid and reliable than the Cheyenne index because the volume of gas transactions reported at the Rockies location is usually between 50% and 400% higher than at Cheyenne.[3]

9. The Indicated Shippers also argue that the high-low cash-out pricing is not justified under Order No. 637, which states that "a pipeline may include in its tariff transportation penalties only to the extent necessary to prevent impairment of reliable service."[4] The protest points to a number of cases claiming to support the proposition that the Commission will only allow a pipeline to implement harsher penalties if it demonstrates that the existing penalty structure does not adequately deter abuses.[5] The Indicated Shippers take the position that high-low pricing is a harsher penalty and therefore not permissible unless the pipeline proves the new scheme is necessary to prevent actual arbitrage. The Indicated Shippers also believe that the "no-tolerance nature of the proposed high-low pricing exacerbates the unreasonableness of this penalty scheme."[6] They argue that CIG already has sufficient mechanisms to address gaming, such as refusing to allow the shipper to incur an imbalance or issuing an operational flow order (OFO) directed at the gaming shipper or a general OFO requiring all shippers to remain in balance.

10. Finally, the Indicated Shippers believe that CIG should also be required to credit OBA penalty revenue because OBA parties are also subject to cash-out penalties, and OBA parties that have not incurred a penalty during the pertinent month should receive the penalty credit.

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[3] Indicated Shippers Protest at 4.

[4] 18 C.F.R. §284.12(b)(2)(v) (2005).

[5] *See Cove Point*, 99 FERC ¶ 61,142, at p. 61, 593 (2002); *See Transco*, 91 FERC ¶ 61,004, *reh'g denied and clarified*, 91 FERC ¶ 61,282 (2000); *See ANR*, 103 FERC ¶ 61,252, *reh'g denied*, 105 FERC ¶ 61,236 (2003).

[6] Indicated Shippers Protest at 9.

Discussion

11. The Commission has recognized that cash-out price mechanisms using average price indices allow shippers to engage in price arbitrage by predicting cash-out prices at the end of the month.[7] In arguing whether the specific mechanism proposed by CIG is legitimate, both CIG and the Indicated Shippers cite Order No. 637 as evidence in support of, or as a challenge to, the proposed mechanism.

12. Order No. 637 recognized that arbitrage was occurring, that old penalty systems provided the opportunity for shippers to engage in arbitrage, and that this "demands that pipelines revise the level and structure of their penalty provisions to minimize the opportunity for arbitrage."[8] More importantly, according to Order No. 637, pipelines "may be able to change the methods by which they cash-out imbalances to eliminate the incentives for shippers to borrow gas from the pipeline because the cash-out price is less than the market price for gas."[9] Further, a pipeline need not prove that arbitrage is actually occurring in order to modify its cash-out mechanisms, a pipeline need only demonstrate the opportunity for arbitrage.[10] Thus, pipelines may adjust cash-out mechanisms to reduce arbitrage opportunities without needing to demonstrate the change is necessary to maintain reliable service.[11]

13. Order No. 637 also recognized that penalties should not be the only mechanism used to ensure system reliability and that pipelines should focus on the use of imbalance management services, while still maintaining a penalty structure.[12] CIG already provides

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[7] *See Texas Gas Transmission Corp.*, 97 FERC ¶ 61,349 (2001).

[8] Order No. 637-A FERC Stats. & Regs. ¶ 31,099 at 31,607 (2000), *order on reh'g*, Order No. 637-B, 92 FERC ¶ 61,062 (2000).

[9] *Regulation of Short-Term Natural Gas Transportation Services, and Regulation of Interstate Natural Gas Transportation Services*, Order No. 637, FERC Stats. & Regs. ¶ 31,099 at P 31,314 (2000).

[10] *Texas Gas* at 62,634.

[11] *The Industrials v. FERC*, 426 F.3d 405 at 407 (2005).

[12] *Id.* at p. 219.

a number of imbalance management services.[13] Because it provides these imbalance management services, CIG may revise its penalty structure without acting contrary to the policy espoused in Order No. 637.

14. One of the specific provisions contained in CIG's proposal is the switch from a four week cash-out period to a five week cash-out period, which discourages price arbitrage by making it more difficult for shippers to predict the average price. At the same time, addition of a fifth week does not increase the harshness of the penalty system.[14] The Commission has in the past approved the use of a five week period to calculate average weekly prices, and this approval has withstood challenge in federal court.[15]

15. CIG also proposes the switch to a high-low pricing mechanism, another tool that has been approved by the Commission in prior orders. In contesting this mechanism, the Indicated Shippers cite a number of cases they claim bolster their argument that CIG cannot make its penalty structure harsher.[16] But the switch to a high-low pricing mechanism is not necessarily making the penalty harsher in violation of Order No. 637.

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[13] CIG Initial Filing at 5.

[14] *Texas Gas* at 62,637 (The Commission stated "We find that adding a fifth week appropriately balances the goals of minimizing arbitrage and not imposing undue burdens on customers.").

[15] *The Industrials*, 426 F.3d at 407-08 (citing FERC's approval of a five week period in *Gulf South Pipeline Co.*, 97 FERC 61,069 (2001), *order on reh'g*, 98 FERC 61,068 (2002) in support of FERC's decision to approve a five week period for Northern).

[16] With respect to the cases cited by the Indicated Shippers, all are distinguishable. *Cove Point* involves a different scheme from the high-low cash-out provisions in question here. Further, *Cove Point* is an Order No. 637 compliance filing under section 5 of the Natural Gas Act (NGA), not an application filed under section 4 of the NGA to amend its tariff sheets to prevent arbitrage. *Cove Point LNG Limited Partnership*, 99 FERC ¶ 61,142 (2002). The filing in *Transco* was rejected because Transco was attempting to modify its existing high-low cash-out mechanism in a manner that would result in significant over-recoveries. T*ranscontinental Gas Pipeline Corp*., 91 FERC 61,282 (2000). The cash-out mechanism proposed in *ANR* was ruled invalid because it attempted to impose a five day period rather than a five week period. *ANR Pipeline Company*, 103 FERC ¶ 61,252 (2003).

The Commission views CIG's proposal as more akin to the proposal approved in *Northern* as opposed to the cases cited above. Northern proposed a high-low cash-out mechanism with a five week period, which was subsequently approved by the Commission and upheld by the Court of Appeals.[17]

16. Specifically, the Commission noted in *Northern* that "under the high/low weekly system with the addition of a fifth week, it is possible the high or low weekly average price used will be based on daily prices that are largely unknown even toward the end of the month in which the imbalances are incurred, thereby significantly reducing the opportunity for arbitrage."[18] The Commission continued, stating that it was therefore "reasonable … to permit Northern to modify its cash-out mechanism to reduce the incentive for shippers to engage in such actions."[19] Because CIG's prior penalty mechanism similarly is a type widely recognized to provide opportunity for arbitrage, change to a high-low pricing mechanism is appropriate.

17. The Indicated Shippers argue that "[t]he no-tolerance nature of the proposed high-low pricing exacerbates the unreasonableness of this penalty scheme."[20] Pipelines employ varying uses of tolerance levels, which the Commission finds indicative of the fact that there is more than one just and reasonable way of resolving imbalance tolerances on a pipeline's system.[21] Eliminating tolerance levels in a high-low system in the interest of reducing opportunities for arbitrage is not without precedent. As we said in *Northern,* "Shippers may incur imbalances in the 0 to 3 percent range for the purpose of arbitrage, just as they can incur greater imbalances for that purpose. Thus, the goal of minimizing arbitrage supports the use of the high/low pricing method for all imbalances, not just these in excess of a tolerance level such as three percent."[22]

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[17] *The Industrials*, 426 F.3d at 406.

[18] *Northern Natural Gas Co.*, 107 FERC ¶ 61,252 at P 17 (2004).

[19] *Id.*

[20] Indicated Shippers' Protest at 9.

[21] *ANR Pipeline Co.*, 111 FERC ¶ 61,113 (2005); *See also Texas Gas*, 97 FERC ¶ 61,349 (2001) (where the Commission permitted a high-low cash-out with an in-kind balancing requirement for imbalances within a 0 to 2 percent range).

[22] *Northern* at P 23 (The Commission noted in *Northern* that it also applied this logic in approving the use of a high-low pricing method for all imbalance tolerance levels for other pipelines.).

18. Lastly, CIG is proposing to update one of the published index prices used in the calculation of the cash-out rate to reflect current operational activity.[23] CIG contends that the Cheyenne index price is more indicative of CIG's future purchases for replacement gas owed by shippers through their imbalance activities. This is because the Commission required CIG to provide gas purchased for operational purposes with a lower scheduling priority than firm secondary service.[24] Further, the system west of the Cheyenne has become increasingly constrained due to new pipelines bringing additional gas to the Wamsutter Hub. This has forced CIG to purchase more replacement gas at the Cheyenne Hub.

19. The Commission finds that the Cheyenne index satisfies the requirements set forth in the Commission's *Order Regarding Future Monitoring of Voluntary Price Formation, Use of Price Indices in Jurisdictional Tariffs, and Closing Certain Tariff Dockets*.[25] For the most recent 90 day period, the Cheyenne index has averaged 33,934 MMBtu/day and publishes on every trading day. Both of these factors exceed the Commission threshold requirements of 25,000 MMBtu/day and publication on at least four trading days per week, respectively.[26]

20. In their protest, the Indicated Shippers request the Commission to require CIG to credit OBA penalty revenue. The general Commission policy on crediting penalties is stated in Order No. 637: "to effectively shift pipelines to the use of non-penalty mechanisms … to solve and prevent operational problems, it will be necessary to eliminate the pipelines' financial incentive to impose penalties and OFOs. Thus, the Commission is requiring pipelines to credit the revenues from penalties and OFOs to

[23] CIG provides a schedule showing that there is an increasing trend for volumes nominated for transportation eastward to equal or exceed system capacity and therefore, CIG has been required to purchase more replacement gas at Cheyenne or points south. Its Wyoming system will become more constrained as two new pipelines, Entrega Piceance Lateral and Wyoming Interstate Company, Ltd. (WIC) Piceance Lateral, bring additional gas to the Wamsutter Hub. Additionally, the CIG and WIC systems are fully contracted on a firm basis from Wamsutter east, so these additional volumes will only further limit CIG's ability to schedule operational gas purchases for western Wyoming.

[24] *Colorado Interstate Gas Co.*, 111 FERC ¶ 61,216 (2005).

[25] 109 FERC ¶ 61,184 (2004). *See also Policy Statement on Natural Gas and Electric Price Indices*, 104 FERC ¶ 61,121 (2003).

[26] 109 FERC ¶ 61,184 at P 59-60.

shippers."[27] However, OBAs, while jurisdictional agreements, are contractual arrangements between an interconnection point operator and the pipeline, and generally need not be filed with the Commission. These agreements allow for seamless transportation service to shippers on the pipeline.[28] The Indicated Shippers rely on *Tennessee*[29] in support of their request, but CIG's answer appropriately distinguishes that case.[30] In *Tennessee*, the Commission required Tennessee to include Balancing Parties in penalty revenue credits "because they are subject to penalties *under Tennessee's tariff*."[31] (Emphasis added.) Tennessee had included OBAs as part of tariff-based imbalance services. CIG's tariff, on the other hand, does not subject or include OBAs to its tariff's general balancing provisions (A costs are not included) and so CIG is not required to credit OBA penalty revenues to OBA parties, subject to the provisions of individual OBAs.

<u>The Commission orders</u>:

The tariff sheets listed in the Appendix are accepted.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.

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[27] Order No. 637 at P 31,309.

[28] *See* section 7.4(a) of CIG's tariff, which states "(a)t each point of Receipt and Point of Delivery, Transporter shall reach agreement with the Interconnecting Party as to the Predetermined Allocation Agreement (PDA) to be used. However, if an Operational Balancing Agreement has been agreed to and effective at Point of Receipt or Delivery, no additional PDA is required."

[29] *Tenn. Gas Pipeline Co.*, 104 FERC ¶ 61,063 (2003).

[30] CIG Answer at 12.

[31] *Tenn.* at P 100.

Appendix

Colorado Interstate Gas Co., Docket No. RP06-220-000
Tariff Sheets Accepted, Effective April 1, 2006

First Revised Volume No. 1
Fifth Revised Sheet No. 155
Third Revised Sheet No. 170
Seventh Revised Sheet No. 178
First Revised Sheet No. 181B
Second Revised Sheet No. 229A.01
Fourth Revised Sheet No. 317
Fifth Revised Sheet No. 318