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 Star Central Gas Pipeline, Inc. Docket No. RP04-276-000

ORDER CONDITIONALLY ACCEPTING AND SUSPENDING TARIFF SHEETS SUBJECT TO REFUND AND ESTABLISHING HEARING PROCEDURES

(Issued May 28, 2004)

1. On April 30, 2004, Southern Star Central Gas Pipeline, Inc. (Southern Star), filed a general rate case[1] pursuant to section 4 of the Natural Gas Act (NGA) and Part 154 of the Commission's regulations. Southern Star proposes to modify its rate structure to recover increased annual costs for its jurisdictional services. Southern Star bases its rates on a cost of service of $206.1 million, an increase of $57.4 million over the cost of service underlying its currently effective rates. Southern Star also proposes several changes to its General Terms and Conditions (GT&C). Southern Star requests its proposed tariff sheets become effective June 1, 2004.

2. As set forth in the Appendix, the Commission accepts those tariff sheets reflecting changes to terms and conditions of service that do not have rate implications, effective June 1, 2004, as proposed. The Commission accepts and suspends for five months those tariff sheets having rate implications, to become effective November 1, 2004. This acceptance is subject to refund, certain conditions, and the outcome of the hearing established in this order, as discussed below. This order benefits the public because it helps the Commission ensure that Southern Star's customers pay just and reasonable rates.

[1] See Appendix for list of tariff sheets.

Details of Filing

3. Southern Star proposes increased rates to recover increased operational revenue requirements on its jurisdictional system. Southern Star states its cost increases primarily relate to new construction projects, investment in facilities, and changes in services offered since the previous general rate proceeding for this system.[2]

4. Southern Star bases its rates on a proposed $206.1 million cost of service, an increase of $57.4 million over the cost of service underlying its currently effective rates. The proposed rates would produce an increase in annual, first-year revenue of about $49.4 million above the revenue collected during the base period. Southern Star calculates its cost of service using the twelve-month base period ending January 31, 2004, incorporating adjustments made during a nine-month adjustment period ending October 31, 2004. Southern Star's cost of service includes $77.18 million in operation and maintenance expenses, $26.38 million in depreciation expenses, $4.99 million in amortization expenses, $39.93 million in taxes, a $57.82 million return, and $0.43 million in revenue credits.

5. Southern Star bases its $57.82 million return on a return on equity of 13.94 percent and an overall rate of return of 11.31 percent. Southern Star states the federal corporate income tax rate associated with the return on equity is 35 percent. Southern Star proposes a capital structure of 59.59 percent equity and 40.41 percent debt.

6. Southern Star designs its rates using the straight fixed-variable method of cost classification, cost allocation, and rate design. Southern Star states that its rate design is consistent with the design of its currently effective rates, except in the instant rate case the IT rates reflect the 100 percent load factor rate of the firm rates year round. Southern Star estimates billing determinants of 293.4 million Dt, a decrease of 10.1 million Dt from the level underlying its currently effective rates.

7. Southern Star also proposes four revisions to its terms and conditions of service. Specifically, Southern Star proposes to: (1) calculate reservation charges based on daily rates as opposed to the current monthly rates; (2) reduce its imbalance tolerances; (3) eliminate the ITS/ISS crediting provisions from its tariff since it allocated costs to its interruptible services; and, (4) remove all references to gathering, since it no longer provides that service.

Notice

8. The Commission issued notice of Southern Star's filing on May 5, 2004. Interventions, comments, and protests were due as provided in section 154.210 of the Commission's regulations (18 C.F.R. § 154.210 (2003)). Pursuant to Rule 214 of the Commission's Rules and Practice and Procedure (18 C.F.R. § 385.214 (2003)), all timely

---

[2] See Williams Natural Gas Company, 78 FERC ¶ 61,257 (1997).

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. Numerous parties filed comments and protests,[3] which we discuss below.

Discussion

Rate Issues

9. Parties to the proceeding raise numerous concerns with Southern Star's filing, including, but not limited to, the typical rate case issues: return on equity; cost of service; facility costs; daily billing; billing determinants; management fees; operation and maintenance expenses; cost allocation to interruptible services; capital structure; expansion investments; storage projects; pipeline integrity projects; rate base additions; and accumulated deferred income taxes.

10. Southern Star has not shown that its proposed rates are just and reasonable. The Commission finds that the typical rate case issues raised in the instant filing, along with other concerns that parties raise, require further investigation. Accordingly, the Commission sets those issues for hearing.

Terms and Conditions of Service

11. In addition to the usual rate-case issues, Southern Star also proposes to calculate daily reservation charges, revise its imbalance tolerance levels, eliminate ITS/ISS revenue crediting, and remove all references to gathering services. We accept Southern Star's proposal to remove from its tariff any reference to gathering, since it no longer provides that service. The other three proposals require discussion.

A. Daily Reservation Rates

12. Southern Star proposes to clarify on its rate sheets that it will calculate reservation charges based on daily rates as opposed to monthly rates. In his testimony, James L. Harder argues that in today's marketplace pipelines should price transportation services on a daily basis because gas is transacted on a daily or even intra-day basis.[4]

[3] Parties that filed comments and protests include Aquila, Inc. (Aquila); Atmos Energy Corporation (Atmos); City Utilities of Springfield, Missouri (City Utilities); Duke Energy Trading and Marketing, et al. (Duke); Indicated Shippers; Kansas City Power & Light Company; Kansas Corporation Commission (KCC); Kansas Gas Service; Kansas Municipal Gas Agency; Laclede Gas Company (Laclede); Midwest Energy, Inc. (Midwest Energy); Midwest Gas Users' Association (Midwest); Missouri Gas Energy (MGE); Process Gas Consumers Group (Process Gas); and, Westar Energy, Inc. (Westar).

[4] Exhibit No. SSC-6.1, Page 4.

13. Several parties oppose this proposal and ask for rejection. Midwest, KCC, and Atmos assert that Southern Star fails to justify its proposal or show it to be just and reasonable. Midwest Energy argues that it is difficult to gauge the full impact of this proposal since Southern Star has not yet filed billing determinant information underlying the derivation of its daily rates. Midwest Energy asks the Commission to set this issue for hearing. Kansas Gas contends that going from a monthly demand charge to a daily demand charge creates a significant change in the billing determinants used for storage capacity demand charges. Kansas Gas argues that the Commission should verify the billing determinants required to establish Southern Star's rates. Process Gas asserts Southern Star must demonstrate that going to daily reservation rates would not degrade existing services or create new costs or penalties for shippers without a commensurable benefit. Westar expresses concern that Southern Star proposes no new services to mitigate increases in charges resulting from daily rates.

14. We accept Southern Star's proposal to calculate reservation charges based on daily rates. In Southern Star,[5] the Commission accepted the pipeline's proposal to implement the daily allocation of gas on its system. The Commission held that allocating gas on a daily basis would more accurately accommodate the needs of a marketplace where gas transmission transactions occur on a daily or even intra-day basis, and would allow Southern Star to manage its system more efficiently and effectively. Calculating reservation charges using daily rates merely conforms to how Southern Star operates its system and how it transacts business in the gas marketplace. Also, no party raises any specific possible adverse affects from switching to daily reservation rates. Further, numerous other pipelines currently calculate reservation charges using daily rates.[6] This acceptance, however, is subject to the rehearing outcome in Docket No. RP03-356-002. Further, although we accept this proposal, since the attendant tariff sheets have rate implications, we accept and suspend the revised tariff sheets related to this proposal for five months, as set forth in the Appendix.

B. Elimination of Revenue Crediting Provisions

15. Southern Star proposes to eliminate from section 12 of its GT&C the provision requiring it to credit 90 percent of its ITS and Authorized Overrun Service revenue, and all of its ISS revenue net of costs, to shippers. In his testimony, Daryl R. Johnson contends that Southern Star established its ITS/ISS revenue crediting provisions during the Order No. 636 restructuring era when there was uncertainty about how robust the

---

[5] 105 FERC ¶ 61,034 (2003).

[6] They include, but are not limited to, Dauphin Island Gathering Partners (Fourth Revised Sheet No. 6); El Paso Natural Gas Company (Twenty-Eighth Revised Sheet No. 23); Garden Banks Gas Pipeline, LLC, (Fourth Revised Sheet No. 6); Gulfstream Natural Gas System, LLC, (Original Sheet No. 5); Mississippi Canyon Gas Pipeline, LLC, (Third Revised Sheet No. 6); Northern Border Pipeline Company (Third Revised Sheet No. 98); and Transwestern Pipeline Company (127th Revised Sheet No. 5).

capacity release market would be and what levels of interruptible revenue Southern Star would earn.[7] Johnson asserts that ample history now exists to show that the capacity release market is now sufficiently robust and continues to grow on Southern Star's system. Johnson adds that, in the instant rate case, Southern Star allocated actual costs to ITS and ISS services. He contends that, accordingly, Southern Star no longer needs an interruptible revenue crediting mechanism.

16. Duke asserts that, although it generally supports cost allocation over revenue crediting, it questions whether Southern Star's proposed allocations accurately reflect the values of those services. Process Gas questions why Southern Star must eliminate these provisions if it sells no ITS or ISS service, and asserts that Southern Star presents no compelling rationale to support its proposal. Midwest Energy requests the Commission allow parties to investigate the amount of allocation in any hearing for the instant rate case. KCC contends that IT revenue crediting is an essential element of the Commission's post-Order No. 636 rate policy[8] and that Southern Star should not abandon it here. Midwest asserts these provisions should remain in place to encourage Southern Star to maximize system throughput and to assure it properly credits revenues to firm shippers.

17. We accept Southern Star's proposal to eliminate the ITS/ISS and Authorized Overrun Service crediting provisions from section 12 of its GT&C. Section 284.10(c)(2) of the Commission's regulations provides that pipelines must design rates for Part 284 services, such as those at issue here, "to recover costs on the basis of projected units of services." Accordingly, the Commission generally requires pipelines to allocate costs to each service based on projected units of service, without any revenue crediting.[9] The Commission previously allowed exceptions to this policy where a pipeline lacks sufficient operating experience with its current service offerings to make a reliable projection of units of service to use in allocating costs. For example, during pipeline restructuring pursuant to Order No. 636, the Commission held that the new capacity release program created such uncertainty about post-structuring interruptible throughput, pipelines should credit 90 percent of their interruptible revenues above allocated levels. However, the Commission made clear that once a pipeline had substantial post-structuring experience, the normal policy regarding revenue crediting would apply.[10] In this case, Southern Star explains that it now has enough test period operating experience with both its ITS and ISS services to allocate ITS and ISS costs as part of its cost of service.

---

[7] Exhibit No. SSC 7.1, Pages 14-15.

[8] Citing Colorado Interstate Gas Company and Cheyenne Plains Gas Pipeline Company, LLC, 106 FERC ¶ 61,275 (2004).

[9] See Panhandle Eastern Pipe Line Company, 74 FERC ¶ 61,109 at 61,385-86 (1996).

[10] Id.

18. KCC argues that IT revenue crediting is an essential element of the Commission's post-Order No. 636 rate policy, citing Cheyenne Plains. However, in that order, the Commission considered issuing a certificate for a new pipeline and establishing initial rates pursuant to NGA section 7. Accordingly, there was no operating experience upon which to base a projection of the interruptible service that the new pipeline would provide. As discussed above, in such circumstances an exception to the ordinary policy against revenue crediting is appropriate. Here, by contrast, Southern Star does have operating experience with the relevant services, and its proposed allocation of costs to ITS and ISS services, without revenue crediting, is consistent with the Commission's Part 284 regulations as amended by Order Nos. 636 and 637.

19. Several shippers, however, express concerns over the amount of costs that Southern Star proposes to allocate to its ITS and ISS services, and opine those costs warrant further discussion. Accordingly, we set Southern Star's proposed cost allocations for hearing. Also, even though we accept Southern Star's proposal to remove the interruptible crediting provisions from its tariff, we find that the revenue crediting provisions should remain in effect until Southern Star's revised rates become effective. Accordingly, we accept and suspend for five months the pertinent tariff sheets, as set forth in the Appendix.

C. Imbalance Mechanism

20. Southern Star proposes to reduce the imbalance tolerance bands in its cash-out mechanism. Southern Star's currently effective tolerance bands are: (1) up to 10-percent imbalance for the first tier; (2) greater than or equal to 10 percent but less than 15 percent for the second tier; (3) greater than or equal to 15 percent but less than 20 percent for the third tier; and (4) greater than or equal to 20 percent for the fourth tier. Southern Star cashes out first-tier imbalances at 100 percent of the applicable index price. It cashes out imbalances in the remaining tiers using increasing or decreasing percentages of the index price depending upon whether the shipper took too much gas from the system or left too much gas on the system.

21. Southern Star proposes to tighten each tolerance band by 5 percent. The resulting proposed tolerance bands are: (1) up to 5-percent imbalance for the first tier; (2) greater than or equal to 5 percent but less than 10 percent for the second tier; (3) greater than or equal to 10 percent but less than 15 percent for the third tier; and (4) greater than or equal to 15 percent for the fourth tier. Southern Star argues the new imbalance tolerance bands reflect current operating conditions on its system.

22. In his testimony, James L. Harder explains that Southern Star implemented the current imbalance tolerance bands in 1993 during Order No. 636 restructuring, when Southern Star did not have adequate equipment or technology to provide daily information to shippers. He argues that now Southern Star provides shippers daily receipt, delivery, imbalance, and storage information by about 11:30 am for the gas day that ended at 9:00 am. Harder contends that shippers can operate within the 5-percent

band, and tightening the tolerance tiers will allow Southern Star to more efficiently operate its system.[11] Harder adds that since Southern Star implemented better monitoring equipment and can provide shippers with daily imbalance information, Southern Star does not require as much system balancing gas. Harder states that Southern Star, in the instant rate case, proposes to reduce its system balancing storage requirements by 50 percent, from 1,650,000 Dt to 825,000 Dt.

23. Harder provides with his testimony Exhibit No. SSC-6.2 showing that, for the twelve-months ending January 2004, shippers have always operated within a 5-percent imbalance band on a system-wide basis with three exceptions, which we discuss below. Harder adds that shippers continue to have numerous options with which to resolve any imbalance should they exceed the 5 percent threshold.

24. Several shippers protest this proposal as unsupported, and ask the Commission to either reject it or set it for hearing. Generally, protesters argue that Southern Star fails to show its proposal is just and reasonable, or provide any operational need for reducing the imbalance tolerance levels. Several shippers also express concern that the proposal could increase their financial burden through increased penalties, higher administrative costs, or the need to use imbalance services.

25. Midwest Energy notes that in Williams,[12] Southern Star's predecessor, the Commission rejected a similar proposal to narrow the imbalance tolerance bands, arguing that Williams failed to identify operational bases for the change. Midwest asserts that Southern Star attempts to turn imbalance management into a profit center. Midwest also argues that Southern Star's proposal unfairly constrains flexibility across the board while not addressing the short-duration system exigencies. KCC adds the proposed reduction in imbalance tolerance is troubling for LDCs with temperature-sensitive loads who must deal with allocations in the face of uncertainties of weather-related changes in their high-priority customers' demands. Process Gas argues that Southern Star's proposal is inconsistent with the Commission's policy set forth in Order No. 637 that gives shippers the option to obtain flexibility and "to make it easier for shippers to remain in balance in the first instance."[13]

26. We accept Southern Star's proposal to revise its imbalance tolerance tiers. A pipeline possesses the initiative under NGA section 4 to propose rates, terms, and conditions for the services it provides.[14] If the pipeline shows that its proposal is just and

[11] Exhibit No. SSC-6.1, Pages 11-12.

[12] Williams Gas Pipelines Central, Inc., 100 FERC 61,232 at 61,824 (2002).

[13] Regulation of Short-Term Natural Gas Transportation Services, and Regulation of Interstate Natural Gas Transportation Services, Final Rule, Order No. 637, 1996-2000 FERC Stats. & Regs. Preambles ¶ 31,091 at 31,309.

[14] 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).

reasonable, the Commission must accept it, regardless of whether other rates, terms and conditions must be just and reasonable.[15] Here, we find that Southern Star satisfactorily shows that its proposal to tighten its imbalance tolerance bands is just and reasonable.

27. Southern Star implemented its currently effective imbalance tolerance bands in 1993, during its Order No. 636 restructuring. At that time, Southern Star lacked the equipment or technology to adequately monitor flows and provide shippers with daily imbalance information. As a result, Southern Star needed the 10-percent penalty-free tolerance band to maintain system integrity in a manner that was not unduly burdensome to its shippers. Now, as Harder explains in his testimony, Southern Star provides shippers daily receipt, delivery, imbalance, and storage information by about 11:30 am for the gas day that ended at 9:00 am. With the more timely information, shippers can more efficiently and effectively stay in balance. Accordingly, modifying the tolerance bands to reflect better system efficiency and management is a reasonable proposal.

28. Here, Southern Star proposes to implement a 5-percent first-tier imbalance tolerance level, and to reduce each subsequent tier by 5 percent. We find Southern Star's proposed imbalance tolerance band modifications to be just and reasonable for several reasons. First, it appears from Exhibit No. SSC-6.2 of Harder's testimony that the majority of shippers are already staying within the proposed 5-percent tolerance band, even though they are currently operating under the less-restrictive 10-percent band. The exhibit shows net shipper imbalances in the Field Area and Production Area for the twelve-months ending January 2004. According to the exhibit, on only three occasions over that period did net shipper imbalances exceed the proposed 5-percent penalty-free imbalance tolerance band,[16] and on those occasions imbalances were only slightly excessive.

29. Second, Southern Star's currently effective 10-percent first-tier imbalance tolerance level is more generous than the first-tier levels of any other jurisdictional pipeline with which it interconnects. Currently, Southern Star interconnects with five jurisdictional interstate pipelines that have a first-tier imbalance tolerance level of 5 percent. They include ANR Pipeline Company, Colorado Interstate Gas Company, Natural Gas Pipeline Company of America, Panhandle Eastern Pipe Line Company, and Questar Pipeline Company. Southern Star also interconnects with Northern Natural Gas Company, which has a first-tier imbalance tolerance level of 3 percent. Accordingly, implementing a 5-percent first-tier imbalance tolerance level would not subject shippers

---

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

[16] For May 2003, the Market Area imbalance was -5.06 percent; for October 2003 the Production Area imbalance was 6.70 percent; and, for November 2003, the Production Area imbalance was 8.30 percent.

to imbalance tolerance levels more restrictive than what they encounter elsewhere in the operating area; rather, it would place Southern Star on more equal footing with other pipelines operating in its region.

30. Third, tightening the imbalance tolerance tiers will also allow Southern Star to operate its system more efficiently, reducing system costs. When Southern Star implemented its 10-percent imbalance tolerance in 1993, effective monitoring and information dispersal were not available. As a result, Southern Star was forced to use costly operational storage and line pack to keep its system in balance. Now, with the advent of better monitoring and information dispersal, shippers are better able to stay in balance. As a result, Southern Star does not require as much operational storage or line pack to keep its system in balance. In the instant filing, because of better monitoring and information, Southern Star proposes to reduce its system balancing storage requirements by 50 percent,[17] which would reduce Southern Star's imbalance costs. This excess storage capacity would then be available to shippers, increasing their system options and flexibility, and reducing system costs.

31. Finally, Southern Star offers a host of imbalance management tools for shippers to better manage their imbalances, most which were not available to shippers when Southern Star implemented its 10-percent first-tier tolerance band in 1993. They include: (1) imbalance netting and trading; (2) the use of storage services to resolve imbalances; (3) shippers' ability to adjust nominations for the remainder of the imbalance month; (4) park and loan service under Rate Schedule PLS; and (5) a cash-out mechanism. These imbalance management tools will more effectively enable shippers to stay in balance.

32. With regard to Midwest Energy's concerns, we find that circumstances have changed since Williams made its proposal. Southern Star now has better and more extensive flow controls and monitoring equipment, provides daily balancing information to shippers, and now has daily system allocation.

Suspension

33. Based on a review of the filing, the Commission finds that certain of the proposed tariff sheets have not been shown to be just and reasonable, and may be unjust, unreasonable, unduly discriminatory, or otherwise unlawful. Accordingly, the Commission will accept those tariff sheets, as set forth in the Appendix, for filing and suspend their effectiveness for the period set forth below, subject to refund and the conditions in this order.

---

[17] On Page 10 of his testimony, James L. Harder states that Southern Star currently reserves 1,650,000 Dt of storage for system balancing. In the instant rate case, Southern Star proposes to reduce system balancing storage to 825,000 Dt.

34. 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.[18] 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.[19] Such circumstances do not exist here. Accordingly, the Commission will exercise its discretion to suspend certain tariff sheets identified in the Appendix for the maximum period and permit the rates to take effect on November 1, 2004, subject to refund and the conditions set forth in the body of this order and the ordering paragraphs below.

<u>The Commission orders:</u>

(A) As set forth in the Appendix, we accept Southern Star's tariff sheets that revise terms and conditions of service and do not have rate implications, effective June 1, 2004, as proposed. We accept and suspend Southern Star's tariff sheets having rate implications to become effective November 1, 2004, subject to refund, the conditions set forth in this order, and the outcome of the hearing establish in this order.

(B) Pursuant to the authority of the Natural Gas Act, particularly sections 4, 5, 8, and 15 thereof, and the Commission's rules and regulations, a public hearing is to be held in Docket No. RP04-276-000 concerning the lawfulness of Southern Star's proposed rates.

(C) A presiding administrative law judge, to be designated by the Chief Administrative Law for that purpose pursuant to 18 C.F.R. ' 375.304, must convene a prehearing conference in this proceeding to be held within 20 days after issuance of this order, in a hearing room of the Federal Energy Regulatory Commission, 888 First Street, NE, Washington, DC 20426. The prehearing conference is 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 in accordance with this order and the rules of practice and procedure.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.

---

[18] <u>See</u> Great Lakes Gas Transmission Company, 12 FERC ¶ 61,293 (1980) (five-month suspension).

[19] <u>See</u> Valley Gas Transmission, Inc., 12 FERC ¶ 61,197 (1980) (one-day suspension).

Appendix

Southern Star Central Gas Pipeline, Inc.
Original Volume No. 1

Tariff Sheets Accepted Effective June 1, 2004

First Revised Sheet No. 100
First Revised Sheet No. 101
First Revised Sheet No. 109
First Revised Sheet No. 110
First Revised Sheet No. 117
First Revised Sheet No. 123
First Revised Sheet No. 124
First Revised Sheet No. 128
First Revised Sheet No. 143
First Revised Sheet No. 203
Fifth Revised Sheet No. 244
Third Revised Sheet No. 245

Tariff Sheets Conditionally Accepted and Suspended Effective November 1, 2004

First Revised Sheet No. 1
Third Revised Sheet No. 10
Third Revised Sheet No. 11
Second Revised Sheet No. 12
Third Revised Sheet No. 105
Third Revised Sheet No. 106
First Revised Sheet No. 107
First Revised Sheet No. 113
First Revised Sheet No. 115
Third Revised Sheet No. 120
Third Revised Sheet No. 121
First Revised Sheet No. 127
First Revised Sheet No. 130
Third Revised Sheet No. 135
Third Revised Sheet No. 136
First Revised Sheet No. 140
Third Revised Sheet No. 141
First Revised Sheet No. 264
First Revised Sheet No. 265

First Revised Sheet No. 266

Southern Star Central Gas Pipeline, Inc.
Original Volume No. 2

Tariff Sheet Conditionally Accepted and Suspended Effective November 1, 2004

First Revised Sheet No. 327