125 FERC ¶ 61,152
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Joseph T. Kelliher, Chairman;
Suedeen G. Kelly, Marc Spitzer,
Philip D. Moeller, and Jon Wellinghoff.

Colorado Interstate Gas Company — Docket No. RP07-667-001

ORDER ON REHEARING

(Issued November 7, 2008)

1. On March 31, 2008, Colorado Interstate Gas Company (CIG) filed a request for rehearing of the Commission's February 29, 2008 order in this proceeding.[1] In that order, the Commission rejected CIG's proposal to adjust its cash-out System Index Price and cash-out Index Price (collectively, cash-out prices).[2] For the reasons stated below, we deny CIG's request for rehearing.

I. Cash-out System Index Price

A. Background

2. Under CIG's existing tariff, the cash-out System Index Price, which CIG primarily uses to cash out shipper net monthly imbalances by applying a market-related rate to end-of-month imbalances, is defined as the average weekly price among the North and South reporting points over a five-week period.[3] CIG applies the highest North/South weekly

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[1] *Colorado Interstate Gas Co.*, 122 FERC ¶ 61,191 (2008) (February 29, 2008 Order).

[2] The February 29, 2008 Order also addressed CIG's proposal, in Docket No. RP07-666-000, to revise its fuel and lost, unaccounted for and other fuel (FL&U) gas tracking mechanism. Although the Commission previously addressed the proposals in Docket Nos. RP07-666-000 and RP07-667-000 in the same order, it did not consolidate the two dockets. This order addresses only CIG's proposal to modify its cash-out prices, and another order will separately address a rehearing request concerning Docket No. RP07-666-000.

[3] The average weekly price is composed of the average of the daily midpoint index prices for Rockies-Cheyenne Hub (North) and Oklahoma-NGPL, Mid-Continent (South), as published in Platt's Gas Daily Price Guide for that week.

average price to cash out gas quantities that shippers owe to CIG and the lowest North/South weekly average price to cash out quantities that CIG owes to shippers. CIG's current cash-out provisions are themselves a relatively recent tariff change that has already increased the severity of CIG's cash-out regime to address concerns of arbitrage opportunities.[4]

3. In its August 31, 2007 filing, CIG again proposed to revise its method for determining the System Index Price so that instead of combining the weekly average prices at the North *and* South reporting points, CIG would use the higher or lower weekly average price at the North *or* South reporting point. Thus, under CIG's proposal, if a shipper owes gas to CIG, the System Index Price would be the highest of the weekly averages from either the North or South pricing points; if CIG owes gas to a shipper, however, the System Index Price would be the lowest of the weekly averages from either the North or South pricing points.

B. <u>February 29, 2008 Order</u>

4. In the February 29, 2008 Order, the Commission rejected CIG's proposed modifications to its System Index Price because CIG did not show that it was experiencing operational difficulties or that its shippers were arbitraging the system under its existing cash-out mechanism. Citing Order No. 637, the Commission explained that while pipelines may structure their cash-out provisions to eliminate incentives for shippers to arbitrage their systems, such cash-out provisions are not without their limits.[5] The Commission stated that for a pipeline to increase the severity of its cash-out provisions in light of an obvious arbitrage incentive, "a pipeline need not prove that arbitrage is actually occurring . . . , a pipeline need only demonstrate the opportunity for arbitrage."[6] At the same time, the Commission noted that a pipeline must also show that

[4] *Colorado Interstate Gas Co.*, 114 FERC ¶ 61,333 (2006).

[5] *Regulation of Short-Term Natural Gas Transportation Services and Regulation of Interstate Natural Gas Transportation Services*, Order No. 637, FERC Stats. & Regs. ¶ 31,091, at p. 31,314-15, *clarified*, Order No. 637-A, FERC Stats. & Regs. ¶ 31,099, *reh'g denied*, Order No. 637-B, 92 FERC ¶ 61,062 (2000), *aff'd in part and remanded in part sub nom. Interstate Natural Gas Ass'n of America v. FERC*, 285 F.3d 18 (D.C. Cir. 2002), *order on remand*, 101 FERC ¶ 61,127 (2002), *order on reh'g*, 106 FERC ¶ 61,088 (2004), *aff'd sub nom. American Gas Ass'n v. FERC*, 428 F.3d 255 (D.C. Cir. 2005).

[6] *Colorado Interstate Gas Co.*, 114 FERC ¶ 61,333 at P 12 (citing *Texas Gas Transmission Corp.*, 97 FERC ¶ 61,349, at 62,634 (2001) (*Texas Gas*)).

its proposed cash-out mechanism does not go beyond what is necessary to minimize the opportunity for arbitrage.[7]

5. Reviewing CIG's proposed System Index Price in the February 29, 2008 Order, the Commission recognized that CIG recently implemented cash-out provisions designed to prevent imbalance arbitrage opportunities.[8] Thus, CIG's current cash-out mechanism includes standard arbitrage-deterring features (i.e., a high/low mechanism and the addition of a fifth week) that have been consistently approved by the Commission and upheld by the United States Court of Appeals for the District of Columbia.[9] The Commission further noted that while CIG set forth a reasonable case as to why arbitrage may currently exist on its system, CIG made no showing that its cash-out mechanism, which was specifically designed to prevent arbitrage, has been inadequate in doing so.

6. The Commission cited examples of cash-out mechanisms that went too far in attempting to deter arbitrage, noting "the Commission's general reluctance to increase the severity, or harshness, of high/low cash-out pricing mechanisms where the effect would be to increase the 'high' price for cash-out sales by the pipeline and decrease the 'low' price for cash-out purchases."[10] The Commission found that CIG's proposed System Index Price methodology, though different in form from proposals rejected by the Commission, had the same effect of polarizing the high and low prices and therefore went beyond what is necessary to prevent arbitrage.[11]

7. The Commission stated that because CIG is requesting to increase the severity of a mechanism already designed to deter arbitrage, it must make some minimum showing

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[7] *Texas Gas*, 97 FERC at 62,632-33 (rejecting a proposed daily high/low index price change as going beyond what is necessary to minimize arbitrage).

[8] *See Colorado Interstate Gas Co.*, 114 FERC ¶ 61,333 (approving CIG's proposal to modify its existing cash-out mechanism from one that used the average of two pricing points over a four-week period to one using a high/low pricing mechanism among the two points over a five-week period).

[9] *Id.* P 15 (citing *The Industrials v. Fed. Energy Regulatory Comm'n*, 426 F.3d 405, 406 (D.C. Cir. 2005) (*The Industrials*)).

[10] February 29, 2008 Order at P 54.

[11] *See id.* P 53 (citing *The Industrials*, 426 F.3d at 407-08; *ANR Pipeline Co.*, 103 FERC ¶ 61,252 (2003), *order on reh'g*, 105 FERC ¶ 61,236 (2003) (*ANR*); *Williams Gas Pipelines Central, Inc.*, 100 FERC ¶ 61,232 (2002), *order on reh'g*, 102 FERC ¶ 61,119 (2003) (*Williams*); *Transcontinental Gas Pipe Line Corp.*, 91 FERC ¶ 61,004 (2000) (*Transco*)).

that it is experiencing operational difficulties or that its shippers are arbitraging its system. The Commission further stated that without any discussion of CIG's experience under its current System Index Price, the Commission could not find CIG's proposal to be just and reasonable.

C. Rehearing Request

8. On rehearing, CIG states that it proposed the above-described modifications to its cash-out mechanism to reduce the opportunity for parties to engage in price arbitrage, to better reflect market realities, and to respond to operational challenges on its system. CIG asserts that prior to the February 29, 2008 Order, the Commission consistently permitted pipelines to modify their cash-out mechanisms based solely on a showing that shippers have the opportunity to game the system through price arbitrage, and that high/low pricing reduces that opportunity.[12] CIG further states that the Commission has specifically held that pipelines are not required to show actual gaming, cost under-recovery or operational harm to implement high/low pricing.[13] CIG argues that by requiring CIG to show that it is experiencing operational difficulties or that its shippers are arbitraging the system, the Commission has departed from established precedent that did not require such showings to implement a high/low pricing mechanism.

9. Furthermore, CIG contends that the Commission failed to provide a reasonable explanation for departing from its prior standard, which required a showing of only the opportunity for arbitrage, for accepting a high/low mechanism based on four or five weekly average prices. CIG notes that the Commission relied on *The Industrials*,[14] which discussed other cash-out modifications rejected by the Commission because they went "too far," but argues that the Commission failed to provide a reasoned explanation as to why CIG's proposal in this proceeding goes "too far." CIG further argues that its high/low pricing proposal, which is based on geographic area, is more analogous to the

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[12] CIG, Rehearing Request at 7 (citing *Colorado Interstate Gas Co.*, 114 FERC ¶ 61,333; *Northern Natural Gas Co.*, 105 FERC ¶ 61,172 (2003); *Gulf South Pipeline Co.*, LP, 98 FERC ¶ 61,068 (2002); *Transcontinental Gas Pipe Line Corp.*, 98 FERC ¶ 61,213 (2002); *Guardian Pipeline, LLC*, 102 FERC ¶ 61,081 (2003)).

[13] CIG, Rehearing Request at 8 (citing *Colorado Interstate Gas Co.*, 114 FERC ¶ 61,333 at P 12; *Texas Gas*, 97 FERC at 62,634-35).

[14] *The Industrials*, 426 F.3d 405.

average weekly high/low pricing mechanisms that the Commission has routinely approved than the mechanisms in the three cases rejecting proposed cash-out mechanisms discussed in *The Industrials*.[15]

10. CIG argues that in two such cases, *ANR* and *Williams*, the Commission rejected daily or rolling five-day cumulative imbalance penalties that would restrict the flexibility that shippers had to run imbalances during the month, and that in neither case was deterring arbitrage offered as a reason for the more restrictive balancing requirement. With respect to the other case cited in *The Industrials*, *Transco*, CIG states that the Commission treated together a proposal that would have reduced tolerance levels as well as the period of time used to calculate the index price, rejecting the proposal as punitive and unjustified. CIG states that in a later case, *Texas Gas*, the Commission distinguished *Transco* by stating that the proposal in that case was more like a daily high/low pricing method, which the Commission rejected, than the five-week high/low cash-out mechanism that the Commission approved.

11. CIG argues that its proposal does not involve shortening the time period before which shippers must pay a cash-out charge; nor does CIG propose to use an index for a period shorter than a week or reduce shippers' flexibility to resolve imbalances by delivering more or less gas during the month. Rather, CIG asserts that its proposal is similar to an average weekly high/low mechanism that the Commission routinely approves. CIG argues that while these mechanisms use high/low pricing to deter arbitrage within the month, its mechanism aims to deter arbitrage among different geographical areas. CIG further argues that although such mechanisms are different in form, they conceptually function in the same manner. CIG argues that the rationale in the February 29, 2008 Order, that the Commission is reluctant to polarize the high and low prices of an existing high/low pricing mechanism, is not correct. CIG asserts that the proposals in *ANR*, *Williams*, and *Transco* were rejected because they shortened the monthly period to resolve imbalances or the time period over which the index was calculated, not because they polarized cash-out prices.

12. CIG next argues that the Commission erred by failing to take into account the operational benefits resulting from CIG's proposal. CIG states that the price disparity between the lower-priced North and the higher-priced South has existed for several years, resulting in constraints at the northern end of its system. CIG asserts that these constraints are exacerbated by fuel imbalances and shipper imbalance activity that result from shippers packing the cheaper North system and drafting the more expensive South

[15] *Id.* (citing *ANR*, 103 FERC ¶ 61,252, *order on reh'g*, 105 FERC ¶ 61,236; *Williams*, 100 FERC ¶ 61,232, *order on reh'g*, 102 FERC ¶ 61,119; *Transco*, 91 FERC ¶ 61,004).

system.[16] CIG argues that its proposal is designed to address these operational constraints in two ways—by deterring imbalances and by providing CIG with an incentive to purchase make-up gas supplies in the South. CIG states that under the current mechanism, it is penalized for buying more than 50 percent of its make-up gas in the South because it would pay more to replenish its linepack than the cash-out price paid by the shipper that encroached upon its linepack in the North.[17] CIG argues that its proposal would allow it to purchase replacement volumes at a price that more accurately correlates with the cash-out price paid by the shippers that took the volumes and that it would create displacement capacity that would help alleviate North-to-South capacity constraints.

D. Discussion

13. We remain unconvinced that CIG has shown its proposed System Index Price to be just and reasonable, and we therefore deny rehearing of our February 29, 2008 Order. Although the Commission has permitted pipelines to increase their cash-out prices in the face of an obvious arbitrage incentive without proving that arbitrage is actually occurring, there are limits to how far a pipeline may go in ratcheting up its cash-out provisions without making some kind of showing that it is facing operational difficulties, under-recovering its costs, or experiencing inordinately large imbalances. The Commission enforces these limits in order to prevent pipelines from restricting shippers' flexibility as well as to avoid the distortion of market forces that would result from excessive penalty levels.[18]

14. The Commission announced its current policy on imbalance penalties in Order No. 637 and Order No. 637-A. In Order No. 637, the Commission stated, "[a] pipeline may include in its tariff transportation penalties only to the extent necessary to prevent the impairment of reliable service."[19] Elaborating on this rule, the Commission noted the importance of crafting targeted penalty provisions that focus directly on the harm to a pipeline's system, rather than broad penalties that limit shipper flexibility. In doing so, the Commission allowed pipelines to amend their cash-out prices to deter gaming, stating

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[16] A draft occurs when a shipper takes more gas from CIG than it has delivered, thereby depleting CIG's linepack. A pack occurs when a shipper takes less gas from CIG than it has delivered, thereby increasing CIG's linepack.

[17] CIG notes that under its cost/revenue true-up, accepted in Docket No. RP07-666-000, it would not face an economic penalty on an annual basis; however, its monthly purchases and sales would have a direct impact on cash flows.

[18] *Transco*, 91 FERC ¶ 61,004 at 61,018.

[19] Order No. 637, FERC Stats. & Regs. ¶ 31,091 at 31,314.

that "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."[20] In Order No. 637-A, the Commission affirmed this policy, stating that "the fact that arbitrage is occurring . . . demands that pipelines revise the level and structure of their penalty provisions to minimize the opportunity for arbitrage."[21] Thus, as noted by the United States Court of Appeals for the District of Columbia Circuit, Order Nos. 637 and 637-A stand for the principle that "pipelines may properly seek to deter arbitrage. Yet, lest cash-out rules unduly limit shipper flexibility, pipelines' efforts against arbitrage should not go too far."[22]

15. Not long ago, the Commission approved CIG's existing tariff provisions—a five-week high/low cash-out mechanism.[23] In that case, the Commission approved the high/low mechanism because CIG's cash-out mechanism at the time (i.e., a four-week average price mechanism) was "a type widely recognized to provide opportunity for arbitrage."[24] Therefore, CIG was not required to show that arbitrage was actually taking place on its system. Here, the situation is different, since CIG's existing high/low cash-out mechanism has a structure that the Commission has already found is adequate to prevent the opportunity for arbitrage. Nevertheless, CIG is now proposing a much more extreme high/low payment divergence. Therefore, to replace this current mechanism with a much more severe one, CIG must make a showing that its proposed cash-out revisions are actually necessary either to deter arbitrage that is in fact occurring, or to address identifiable operational issues.

16. As discussed in the February 29, 2008 Order, the Commission is reluctant "to increase the severity, or harshness, of high/low cash-out pricing mechanisms where the effect would be to increase the 'high' price for cash-out sales by the pipeline and decrease the 'low' price for cash-out purchases."[25] The United States Court of Appeals for the District of Columbia Circuit summarized such instances as follows:

> [T]he Commission has rejected mechanisms that provided cash-outs for imbalances measured over periods much shorter than a month. *ANR Pipeline Co.*, 103 FERC ¶ 61,252 (2003),

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[20] *Id.* at 31,314-15.

[21] Order No. 637-A, FERC Stats. & Regs. ¶ 31,099 at 31,607.

[22] *The Industrials*, 426 F.3d at 407.

[23] *Colorado Interstate Gas Co.*, 114 FERC ¶ 61,333.

[24] *Id.* P 16.

[25] February 29, 2008 Order at P 54.

> *order on reh'g*, 105 FERC ¶ 61,236 (2003) (five days); *Williams Gas Pipelines Central, Inc.*, 100 FERC ¶ 61,232 (2002), *order on reh'g*, 102 FERC ¶ 61,119 (2003) (daily). The shorter the period of calculation, the more stringent the sanction is likely to be, as the shipper gets less benefit from the netting out of short-term positive and negative imbalances. As a result, the proposals went too far in reducing arbitrage incentives. And the Commission has similarly rejected systems that would have used as benchmarks the high/low of average prices from periods of less than one week, as in *Transcontinental Gas Pipe Line Corp.*, 91 FERC ¶ 61,004 (2000).[26]

17. CIG distinguishes *ANR*, *Williams*, and *Transco* from the case at hand, arguing that these cases involved proposals that limited shippers' flexibility to resolve imbalances within the monthly cash-out period by either shortening the time before which shippers must pay a cash-out charge or using an index for a period shorter than a week. CIG argues that the Commission rejected these proposals because they limited shippers' flexibility, not because they "polarized" a high/low cash-out pricing scheme by creating too extreme a spread between the high and low cash-out prices. Thus, CIG argues that its proposal should be approved without requiring CIG to show that shippers are actually arbitraging its system, because its proposal does not limit shippers' flexibility.

18. CIG is correct to note that some issues of shipper flexibility implicated in *ANR* and *Williams* are not implicated here. Because those proposals involved restricting shippers' abilities to resolve intra-month imbalances, they limited shipper flexibility and therefore went "too far" in their effort to minimize arbitrage. Such flexibility issues were also implicated in *Transco*, although in that case, the pipeline also proposed to change its method of calculating its cash-out price by using the higher or lower of the average of the three highest or lowest daily midpoint prices, rather than the higher or lower of a weighted weekly average price.[27] Thus, while the Commission did consider the flexibility-limiting aspects of Transco's proposal, it specifically found that the pipeline failed to show that its current cash-out imbalances presented particular difficulties to support the increased penalties it proposed.[28] *Transco*, therefore, is not so distinguishable as CIG asserts.

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[26] *The Industrials*, 426 F.3d at 407.

[27] *Transco*, 91 FERC ¶ 61,004 at 61,017.

[28] *Id.* at 61,020.

19. Furthermore, in *Texas Gas*, the Commission accepted a five-week high/low mechanism based on weekly average prices and specifically rejected a proposal to use a daily high/low pricing mechanism, finding that the latter goes beyond what is necessary to minimize arbitrage.[29] The Commission found that the weekly high/low mechanism would be more representative of the highs and lows throughout the cash-out period than the daily high/low mechanism.[30] The daily high/low mechanism in *Texas Gas* was considered on its own merits, and was found to yield a less representative price when judged in terms of the cost of gas under- or over-taken by a shipper causing an imbalance. Thus, in *Texas Gas*, the Commission recognized that a cash-out mechanism should result in a cash-out price that is broadly representative of the average price over the cash-out period, eschewing the more extremely polarized high and low prices that would result from a daily high/low mechanism. This broadly representative cash-out price "better balances the goals of deterring arbitrage, while not imposing an unnecessarily high penalty on the customers."[31]

20. CIG argues that its high/low pricing mechanism is similar to the weekly high/low mechanisms typically approved by the Commission, with the only distinction being that those mechanisms aimed to counteract a form of temporal arbitrage, while CIG's instant proposal aims to counteract a form of geographic arbitrage. We disagree. CIG's proposed mechanism would not only yield a cash-out price that is less representative of the price of gas on its system during the relevant period, it would also increase the level of penalties without any showing that such penalties are necessary to curb arbitrage. Such increased penalties are inconsistent with the intent of Order No. 637 as they likely would "often operate to limit and distort market forces."[32] Furthermore, as noted above, CIG already has a cash-out mechanism that is specifically designed to deter arbitrage. Therefore, we are not persuaded to accept CIG's proposal simply on its assertion that arbitrage may be occurring on its system.[33]

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[29] *Texas Gas*, 97 FERC at 62,632-33.

[30] *Id.* at 62,633.

[31] *Id.*

[32] *Transco*, 91 FERC ¶ 61,004 at 61,018.

[33] The February 29, 2008 Order acknowledges CIG's hypothesis that arbitrage could be taking place on its system or that shippers are packing the northern portion of its system and drafting on the southern portion; however, CIG has not actually shown this to be the case. We have never adopted CIG's assertion that such arbitrage is actually taking place on CIG's system, as CIG argues in its request for rehearing. As noted above, there is no hard evidence to support this assertion, and CIG already utilizes a sufficiently divergent price spread in its high/low cash-out mechanism to deter shipper arbitrage.

21. CIG also argues that the Commission failed to consider "operational benefits" that would result from its proposal. The Commission allows pipelines to use penalties to deter shipper conduct that may threaten the operational integrity of the pipeline. However, penalties should not be so high as to inhibit normal business activity. As discussed above, CIG has provided no evidence that its current cash-out provisions are insufficient to deter potentially harmful behavior. Further, CIG's claims of "operational benefits" fail to illustrate the operational harm such benefits are meant to cure. Instead these putative benefits appear to be financial benefits that would accrue to CIG.

22. Moreover, we disagree that CIG's proposal will provide an incentive for it to purchase more expensive replacement gas. Instead, as with any business, CIG's incentive will be to purchase the least expensive gas it can find and use. Furthermore, the Commission approved CIG's valuation-based cost/revenue true-up mechanism for operational purchases and sales in the February 29, 2008 Order. This true-up mechanism is designed to account for the net cost or revenue of gas balancing activities. CIG acknowledges that in light of this new cost/revenue true-up mechanism, it will not be economically penalized on an annual basis; however, CIG asserts that monthly purchases and sales may have an impact on cash flows. However, CIG fails to quantify or explain the relevance of this impact in support of an extreme high/low cash-out regime. Nor does CIG explain the link between improved cash flows and operational benefits such that the improved cash flows justify CIG's proposal for the increased penalties proposed here.[34] Therefore, we reject CIG's need for a further "financial incentive."

23. In *The Industrials,* the court recognized, that "in the absence of a perfect mechanism, one that neither overdeters nor underdeters arbitrage, pipelines and the Commission can be expected to test the waters, gradually ratcheting up any scheme that generates substantial imbalances."[35] Such is the situation presented here. CIG has recently instituted a high/low System Index Price to deter arbitrage and now proposes to ratchet up the high/low spread for its System Index Price. However, it does so without showing that its existing mechanism is generating substantial imbalances, causing under-recovery of costs, or presenting operational difficulties. CIG simply repeats its contention that its current mechanism provides the opportunity for arbitrage. As

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[34] Moreover, this line of argument belies what appears to be a significant reason behind CIG's proposal to revise its high/low cash-out mechanism, i.e., improving its cash flows. Improved cash flows, however, are an inappropriate basis upon which to support penalties. "Order No. 637 required pipelines to credit penalty revenues to ensure the pipeline did not have an incentive to invoke penalties to raise revenue." *See Columbia Gas Transmission Corp.*, 105 FERC ¶ 61,127, at P 18 (2003) (citing Order No. 637, FERC Stats. & Regs. ¶ 31,091 at 31,315).

[35] *The Industrials*, 426 F.3d at 408.

discussed above, without some showing that arbitrage is occurring or that its proposal does not go beyond what is necessary to deter arbitrage, we decline to approve CIG's proposal.

II. Cash-out Index Price

A. Background

24. In its August 31, 2007 filing, CIG also proposed to change the manner in which it calculates the cash-out Index Price, which CIG uses, among other things, to convert liquid revenues to gas equivalents in computing shrinkage in its quarterly FL&U reimbursement percentage. In place of its current tariff provision defining the Index Price as the average of daily midpoint index prices for the North and South index points, CIG proposed to always use the higher of the daily North or South prices in calculating cash-out prices, thereby increasing the FL&U recovered from shippers to a level CIG asserts is more economically neutral.

B. February 29, 2008 Order

25. The February 29, 2008 Order rejected CIG's proposed modifications to its Index Price because CIG did not sufficiently support its proposal. CIG argued, but did not show, that it often pays more money to purchase replacement gas than it recoups from its shippers through its tracking mechanism. CIG argued that permitting it to use a more extreme pricing mechanism would provide it an incentive to purchase more expensive gas on the South system to resolve North to South constraints. The Commission found that the opposite result would as likely ensue, and that CIG's economic incentive would have it purchasing the least expensive gas to make up for shrinkage volumes, while charging shippers the higher price of more expensive gas. Thus, without more specific information showing that CIG was under-recovering its costs, the February 29, 2008 Order found that CIG's proposed Index Price methodology would act as an impermissible penalty.

C. Rehearing Request

26. On rehearing, CIG states that it proposed the same change to the cash-out Index Price as it proposed to the cash-out System Index Price, described above. CIG asserts that the same operational reasons that support its proposed modification of the System Index Price apply here. Specifically, CIG states that constraints in the North force it to purchase make-up shrinkage volumes related to gas processing activities on the higher priced South system. CIG argues that the current pricing mechanism, therefore, does not reflect CIG's actual purchases and results in a mismatch between CIG's purchase costs and its recovery of those costs in its FL&U tracker. CIG states that its proposal is designed to more closely track the replacement cost of make-up gas for shrinkage

volumes and to provide CIG with a greater incentive to purchase replacement gas on the more expensive South system, which would in turn relieve North to South constraints on CIG's system.

27. CIG objects to the Commission's reasoning in the February 29, 2008 Order, arguing that the purpose of the change was not to deter shipper conduct, but to better align the cash-out Index Price with costs incurred by CIG in purchasing replacement gas. CIG states that although this proposal will reduce the volumes credited to CIG's FL&U charge, all revenues and costs will ultimately be trued up according to the tracking mechanism approved by the Commission in Docket No. RP07-666-000.[36] Furthermore, CIG argues that the Commission erred in its conclusion that the proposed change will provide CIG with an incentive to continue to purchase lower cost gas from the North system because 1) while the change to the index price used to calculate volumes used in the FL&U tracker will reduce the credit, any reduction in the actual cost of replacement gas will increase the credit; and 2) the FL&U tracker requires a true-up, CIG would not benefit from a reduction in the credit in any event. CIG further states that because transportation quantities are scheduled prior to operational gas, CIG is unable to compete with its shippers for capacity in the North, and therefore it must often purchase gas in the South.

D. Discussion

28. On rehearing, we affirm our earlier decision to reject CIG's proposed modification to its cash-out Index Price. CIG continues to assert that its proposal is intended to more accurately align its Index Price with the costs incurred by CIG's purchases of replacement gas. However, CIG does not provide a detailed comparison of where, when and for what price it purchased gas to replace shrinkage volumes, leaving us unable to verify the extent to which the Index Price differs from CIG's actual replacement costs. For instance, CIG asserts that it is often forced to purchase more expensive gas on the South system because it has a lower scheduling priority than shippers on the more constrained North system. However, CIG fails to show either how often this occurs or its economic impact. Moreover, CIG has not shown that it is completely unable to purchase and move replacement volumes on its North system, i.e., that CIG's North system is 100 percent constrained 100 percent of the time. Without such information, we are unable to find CIG's proposal to be just and reasonable.

29. CIG indicates that its proposed Index Price would not result in CIG profiting from its FL&U tracker because ultimately, all revenues will be trued up in its cost/revenue true-up. However, CIG's argument that it will not benefit from a reduced liquids revenue credit is implausible. If CIG always uses the higher of the North or South price to produce a volumetric equivalent of liquids revenue credit, that volumetric equivalent will

[36] February 29, 2008 Order at P 27.

always be lower than it would be using CIG's current Index Price, and shippers will receive a reduced FL&U credit. CIG does not show how the cost/revenue true-up will account for this reduced credit; rather, CIG simply asserts that its proposal will result in a better alignment between liquids revenue credit and the cost of replacement gas. Moreover, if as CIG claims, shippers would not be harmed by its proposed Index Price because the cost/revenue true-up will account for any reduced credit, it appears that the same logic would apply to CIG under its current Index Price. That is, the cost/revenue true-up should ultimately make CIG whole in the event that it might spend more on replacement gas than it realizes through its liquids revenue credit. In any event, if as CIG states, its goal is to be made whole for the costs of replacement gas due to shrinkage, CIG should simply charge shippers for the actual cost of that replacement gas, rather than use a "higher-of" estimate that would leave CIG in the likely position of over-recovering its costs in instances when its actual costs are below the cash-out Index Price.

30. CIG disputes the Commission's assertion in the February 29, 2008 Order that CIG would have an incentive to continue purchasing the least-cost gas under its proposed "higher of" Index Price. Similar to our disposition of this argument as applied to the System Index Price, we find no evidence that CIG would have so strong an incentive to purchase higher-priced gas, or that such an incentive would, in fact, lead CIG to purchase more expensive replacement gas. Also, as indicated above, we disagree with CIG that these financial incentives to purchase more expensive replacement gas equate to "operational benefits" to the system that would justify the switch to a "higher-of" Index Price.

31. Finally, CIG argues that the February 29, 2008 Order erred in referring to its proposed Index Price as an unjustified penalty provision, because CIG's proposed revision to its Index Price methodology is not intended to affect shipper behavior. Nonetheless, CIG has not shown its proposed Index Price methodology reasonably values shippers' shrinkage volumes, and therefore we deny CIG's request for rehearing.

The Commission orders:

CIG's request for rehearing is denied.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.