UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
William L. Massey, and Nora Mead Brownell.

Tennessee Gas Pipeline Company — Docket Nos. RP00-477-002, RP00-477-003, RP01-18-002, RP01-18-003, RP98-99-007, RP98-99-008 and RP03-183-000

ORDER ON REHEARING AND COMPLIANCE WITH ORDER NO. 637

(Issued July 11, 2003)

I. Introduction

1. On June 3, 2002, Tennessee Gas Pipeline Company (Tennessee) filed in Docket No. RP00-477-003, et al., tariff sheets[1] in compliance with Order No. 637, et seq.[2] and an order on compliance issued April 3, 2002.[3] Also, Tennessee and others filed requests for rehearing of the April 3 Order in Docket No. RP00-477-002, et al. In Order No. 637, the Commission revised, among other things, its regulations relating to scheduling procedures, capacity segmentation, and pipeline penalties to improve the competitiveness and efficiency of the interstate pipeline grid. In this order, the Commission partially grants and denies rehearing, finds that Tennessee has generally complied with the requirements of Order No. 637 and the April 3 Order, as discussed below, subject to

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[1] The tariff sheets are shown on Appendix A.

[2] Regulation of Short-Term Natural Gas Transportation Services and Regulation of Interstate Natural Gas Transportation Services, FERC Stats. & Regs. Regulations Preambles (July 1996-December 2000) ¶ 31,091 (2000) (Order No. 637); order on rehearing, Order No. 637-A, FERC Stats. & Regs, Regulations Preambles (July 1996-December 2000) ¶ 31,099 (2000) (Order No. 637-A); and Order No. 637-B, 92 FERC ¶ 61,062 (2000) (Order No. 637-B), aff'd in part and remanded in part, Interstate Natural Gas Association of America v. FERC, 285 F.3d 18 (D.C. Cir. Apr. 5, 2002), Order on Remand, 101 FERC ¶ 61,127 (2002).

[3] Tennessee Gas Pipeline Company, 99 FERC ¶ 61,017 (2002) (April 3 Order). On April 29, 2002, Tennessee requested an extension time to file in compliance with the April 3 Order. The Office of the Secretary, on May 2, 2002, granted Tennessee an extension of time to file up to June 3, 2002.

certain modifications, and conditionally accepts the proposed tariff sheets effective September 1, 2003, and rejects other sheets.

2. In addition, Tennessee filed on December 2, 2002, tariff sheets[4] in compliance with the Commission's *Order on Remand*.[5] The Commission conditionally accepts certain proposed tariff sheets effective September 1, 2003, and rejects other sheets.

A. Requests for Rehearing and Protest of Compliance Filing

3. Several parties protested Tennessee's compliance filing.[6] On August 6, 2002, Tennessee filed an answer to the comments and protests.[7] The details of their comments and/or protests to the filing are discussed below.

4. In addition, on May 3, 2002, Tennessee, Dynegy Marketing and Trade, Clarksville,[8] Indicated Shippers,[9] Dominion LDCs,[10] NEG Shippers,[11] KeySpan,[12]

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[4]The tariff sheets are shown on Appendix A.

[5]101 FERC ¶ 61,127 (2002).

[6]Interventions 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 (18 C.F.R. § 384.214 (2003)), all timely filed motions to intervene and any motions to intervene out of time filed before the issuance of this order are granted. Granting late intervention at this stage of the proceeding will not disrupt this proceeding or place additional burdens on existing parties.

[7]While the Commission's Rules of Practice and Procedure generally prohibit answers to protests, the Commission will accept the answer to allow a better understanding of the issues. See 18 C.F.R. § 385.213(a)(2) (2003).

[8]The Cities of Clarksville, Springfield, and Portland, Tennessee, the West Tennessee Public Utility District, the Greater Dickson Gas Authority, and the Humphreys County Utility District (Clarksville).

[9]Amerada Hess Corp., Anadarko Petroleum Corp., Chevron U.S.A. Inc., Conoco Inc., ExxonMobil Gas Marketing Co. (a Division of Exxon Mobil Corp.), OXY USA Inc., Shell Offshore Inc. and Texaco Natural Gas Inc. (Indicated Shippers).

[10]The East Ohio Gas Co. (d/b/a Dominion East Ohio) and the Peoples Natural Gas

(continued...)

Process Gas Consumers (PGC) and New England LDCs[13] filed requests for rehearing of the April 3 Order. Their requests are addressed below.

B. Background

5. On August 15, 2000, Tennessee filed in Docket No. RP00-477-000 pro forma tariff sheets in compliance with Order No. 637, et seq. A series of technical and/or settlement conferences were held in this docket. The parties attempted to resolve the proceeding by settlement but the conferences did not produce a settlement. On April 6, 2001, Tennessee submitted a revised compliance filing.

6. On April 3, 2002, the Commission issued an order on Tennessee's compliance filings. The April 3 Order found that Tennessee had, in general, complied with the requirements of Order No. 637. Nonetheless, the April 3 Order required Tennessee to make several modifications to its compliance filing. Rehearing and compliance with these requirements are discussed below.

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[10](...continued)
Co. (d/b/a Dominion Peoples) (Dominion LDCs).

[11]USGen New England, Inc., Selkirk Cogen Partners, L.P., MASSPOWER, Millennium Power Partners, L.P., and PG&E Energy Trading - Gas Corp. (NEG Shippers).

[12]The Brooklyn Union Gas Co. (d/b/a KeySpan Energy Delivery New York), KeySpan Gas East Corp. (d/b/a KeySpan Energy Delivery Long Island), Boston Gas Co., Colonial Gas Co., Energy North Natural Gas, Inc., and Essex Gas Co. (KeySpan).

[13]Bay State Gas Company, The Berkshire Gas Company, Commonwealth Gas Company, Connecticut Natural Gas Corporation, Fitchburg Gas and Electric Light Company, City of Holyoke, Massachusetts Gas and Electric Department, Northern Utilities, Inc., The Providence Gas Company, The Southern Connecticut Gas Company, Valley Gas Company, City of Westfield Gas and Electric Light Department, and the Yankee Gas Services Company. (New England LDCs).

II. Discussion

A. Requests for Rehearing: Docket Nos. RP00-477-002, RP01-18-002 and RP98-99-007

1. Ability of Replacement Shippers to Select Additional Primary Points

a. April 3 Order

7. In Order No. 637, the Commission found that permitting flexibility in the selection of primary points in segmented releases can be important to creating effective competition between pipeline services and released capacity. The Commission required pipelines to justify restrictions on shippers' ability to use additional primary points in segmentation transactions and any deviation from the Texas Eastern/El Paso policy.[14] Under this policy, the releasing and replacement shippers are both able to choose primary points consistent with their mainline contract demand.

8. Tennessee, in its initial compliance filing, stated that it treats its standard firm transportation shipper's requests to change *primary* points the same as a new shipper's request for primary points in similar circumstances. The April 3 Order reviewed Tennessee's tariff, and failed to identify any tariff restriction against a replacement shipper acquiring segmented capacity from requesting a change of those points or obtaining other points on a primary basis. Replacement shippers have contracts with Tennessee and, under Tennessee's tariff, are subject to the same data requirements, time lines and evaluation criteria as any other party requesting service. The Commission, therefore, found that Tennessee's existing tariff, which permits any firm customer with secondary point rights, or a potential firm shipper without distinction as to its class, to request primary points on the same basis, is consistent with the Texas Eastern/El Paso policy. The Commission concluded that if Tennessee's tariff or policy, as inferred by Tennessee's description, established different standards for evaluating requests for primary point capacity for different classes of customers, it would be in violation of both Section 284.7(b)(1) of the Commission's regulations and the Texas Eastern/El Paso policy.

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[14] Order No. 637, FERC Stats. & Regs. Regulation Preambles (July 1996-December 2000) ¶ 31,091, at 31,304.

b. Existing Tariff Rights

i. Tennessee's Request for Rehearing

9. Tennessee states that if the Commission intends that Tennessee should treat any customer, whether releasing shipper, replacement shipper, or potential shipper, the same in that they can bid for and contract for new firm capacity and pay additional reservation charges, then Tennessee does not seek rehearing. If the Commission is trying to equate the ability to move a contracted amount of primary point capacity to another point, to increase the amount of primary point capacity above that paid for in the service agreement without additional reservation charges, then Tennessee states the Commission has no basis in the tariff, law, fact or practice.

10. Tennessee states that its tariff permits shippers to elect substitute primary points.[15] Replacement shippers with segments with primary points have the same right, within the limits imposed by the conditions of release. However, Tennessee states that there has never been an ability for any releasing or replacement shipper to elect additional amounts of primary point capacity. Tennessee states its tariff does not allow a shipper to elevate a lower priority to a primary priority.

11. Tennessee further objects to the finding that either Tennessee's tariff is as interpreted by the Commission, or otherwise is in violation of Section 284.7(b)(1) of the Commission's regulations. Tennessee states it is inconceivable that its tariff, which has been consistently applied, which has been reviewed and affirmed in subsequent proceedings, and for which the Commission made no NGA Section 5 finding that the tariff was unjust and unreasonable, can be suddenly transformed in meaning and scope to become discriminatory in its application.

12. Tennessee argues that the Commission's finding ignores the effect it would have on the releasing shippers. The tariff requires matched primary receipt and delivery points elevations. As replacement contracts are derivative contracts, and as gas volumes are increased through segmented contracts, the releasing shipper's daily transportation quantity increases, therefore increasing the releasing shipper's charges. Tennessee contends further that elevated replacement shipper contract quantities would be included in the releasing shipper's reservation charge calculations, thereby increasing the reservation charge for the releasing shipper.

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[15] Citing Section 4.7 of Tennessee's Rate Schedule FT-A.

13. Tennessee also states that the Commission ignored previous Commission orders addressing this issue as it relates to Tennessee. In the Order No. 636 restructuring proceedings, the Commission addressed the applicability of the Texas Eastern/El Paso policy to Tennessee. In that proceeding, the Commission found that the sum of the maximum daily quantities of shipper's delivery points may not exceed the shipper's transportation quantity. Further, there were operational differences from the precedent case pipelines.[16] The Commission also found that Tennessee's proposal to limit primary points was acceptable, as shippers had access to all delivery points within the receipt and delivery zones and the contract path on a secondary basis. The Commission found further that this proposal did not prevent segmenting the release.[17] Thus, Tennessee concludes, the Commission committed legal error in not addressing why it is now reversing its direct approval of the limitation on the acquisition of primary points.

14. Tennessee also alleges that the Commission erred in failing to address Tennessee's operational concerns. Specifically, if points can be upgraded, Tennessee states that it cannot make the assurance that shippers will only be restricted when there is maintenance, equipment failure or other *force majeure* situations that decrease system capacity. Tennessee contends that its proposed capacity path enhancement proposal was tied together with its proposed elimination of its original proposal to allow elevation of secondary points to primary points. Tennessee states that the Commission cannot cherry pick from the different proposals. The Commission must consider responsible alternatives to its chosen policy, and give reasoned explanation for its rejection of such alternatives.

15. As an alternative, Tennessee proposes that the Commission defer action on the compliance sheets for two years so that Tennessee can assess how well the new capacity path and segmentation work both in achieving the Commission's goals and in comparison to other pipelines. Absent this consideration, Tennessee requests the Commission clarify that Tennessee may turn down a request to elevate secondary points to primary points to ensure contracted levels of firm service and also its ability to assure shippers regarding the capacity path enhancement proposal approved in the April 3 Order.

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[16] Panhandle Eastern Pipe Line Company, 61 FERC ¶ 61,357 (1992) and Texas Eastern Transmission Corp., 62 FERC ¶ 61,015 (1993).

[17] Tennessee Gas Pipeline Co., 64 FERC ¶ 61,020 at 61,248 (1993).

ii. Commission Response

16. The Commission denies Tennessee's rehearing request. Tennessee argues that the Commission, in Tennessee's Order No. 636 proceeding and subsequent orders, reviewed and found Tennessee's tariff consistent with both Order No. 636 and the Texas Eastern/El Paso policy, and maintains that the Commission therefore is prohibited from revising its tariff.

17. In Order No. 637, the Commission specifically revisited these issues, finding that its segmentation policies, including the Texas Eastern/El Paso policy, were not uniformly implemented across the pipeline grid. The Commission codified the requirement that Part 284 open access blanket transportation certificate holders provide for segmentation. The Commission found further that providing replacement shippers with the ability to obtain primary points when available was important to furthering competition between released capacity and pipeline capacity. As the Commission explained in Order No. 637, its Texas Eastern/El Paso policy requires that:

> the releasing and replacement shippers must be treated as separate shippers with separate contract demands. Thus, the releasing shipper may reserve primary points on the unreleased segment up to its capacity entitlement on that segment, while the replacement shipper simultaneously reserves primary points on the released segment up to its capacity on that segment.

18. The purpose of the Commission's policy that replacement shippers should have the opportunity to obtain their own primary points is to enhance competition in the sale of capacity between the pipeline and shippers through segmentation and capacity release. As the Commission explained in Order No. 637-A, if replacement shippers were limited to the use of segmented points on a secondary basis, the pipeline would still retain the right to sell that point capacity on a primary basis. The ability to sell points on a primary basis would provide the pipeline with a competitive advantage over segmented capacity release transactions.[18]

19. Thus, regardless of what provisions the Commission may have approved in earlier proceedings, the purpose of Order No. 637 was to reexamine Tennessee's tariff in light of

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[18] See Natural Gas Pipeline Company of America, 103 FERC ¶ 61,174, at PP 14-25 (2003) (explaining the basis for the Texas Eastern/El Paso policy).

the competitive concerns addressed in Order No. 637. Tennessee cites to its Order No. 636 restructuring proceeding, 64 FERC ¶ 61,020, at 61,248, for the proposition that the Commission has already found that it should not have to comply with the Texas Eastern/El Paso requirements due to operational differences. While that order cites to differences in operation between Tennessee and Texas Eastern and Panhandle as the justification for adopting a different policy, the order fails to identify any operational distinctions. Pursuant to Order No. 637, the Commission has reexamined Tennessee's restriction in this proceeding and found that Tennessee has not justified different treatment.

20. In its rehearing request, Tennessee states: "in contrast to other pipelines, Tennessee allows segmentation in all parts of its system, including the reticulated parts. Tennessee does not review whether segmentation requests are possible; it simply allows them to take place as long as they are within the shipper's transportation path and not part of an already created segment." (Rehearing Request, at 12). In the first place, Tennessee's claimed distinctions are not well developed or clear. However, Tennessee is seeking an exemption from the Texas Eastern/El Paso policy for its entire system; it has not tried to limit its exemption only to the reticulated portions of its system. As a general matter, Tennessee is a straight line pipeline and cannot justify a blanket exemption from the Texas Eastern/El Paso policy because it may have some reticulated portions. Nor can Tennessee justify an exception from the policy for non-segmented releases.[19] Based on its review, the Commission finds Tennessee's tariff, as interpreted by Tennessee, to be unjust and unreaonsable, because it fails to allow replacement shippers to obtain available primary points subsequent to the release. Accordingly, Tennessee is directed to file revised tariff sheets to clarify that replacement shippers are allowed to obtain available primary points subsequent to the release.

21. Tennessee further argues that, under its tariff, if replacement shippers can upgrade secondary points to primary points, the releasing shipper's demand charges should increase. First, Tennessee points to no current tariff provision that would permit it to change a releasing shipper's demand charge as a result of a release transaction. Second, as discussed above, the Commission's Texas Eastern/El Paso policy does not permit such

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[19]The Commission did permit Williston Basin an exemption from the Texas Eastern/El Paso policy for segmented releases where it showed that its entire system was reticulated, and developed a segmentation policy appropriate to its reticulated operations. But the Commission still required Williston Basin to adhere to the Texas Eastern/El Paso policy with respect to non-segmented releases. Williston Basin Interstate Pipeline Company, 99 FERC ¶ 61,327, at 62,394-95.

a charge, and the Commission finds that an attempt to impose such a charge would be unjust and unreasonable. As explained above, the replacement shipper has signed a firm transportation contract with the pipeline, and therefore has the same rights to select primary points equal to its contract demand under its contract, if such points are available.[20] Tennessee does not lose firm transportation revenue, since the releasing shipper is still responsible for paying its full reservation charges under its contract.

22. Moreover, the Commission has established policies that ensure that despite a replacement shipper's ability to select available primary points, pipelines retain a reasonable ability to market available mainline capacity. These policies establish a reasonable balance between the need to enhance competition by providing replacement shippers with the right to obtain primary points and the pipeline's interest in selling available firm capacity. First, replacement shippers can obtain primary points only when those points are available and those points revert to the pipeline for sale at the expiration of the release. Second, if a replacement shipper obtains primary points by changing the releasing shipper's primary points, the change may be permanent and the pipeline can sell the newly available capacity at the original primary points to new shippers. Third, the Commission has allowed Tennessee to use the net present value (NPV) method to allocate point capacity. This method treats the bid of an existing shipper (including a replacement shipper) to change to another primary point without increasing its reservation charge as having an NPV of zero, in contrast to the bid of a new shipper bringing new revenue to the pipeline.[21] This ensures that bids providing additional revenue to the pipeline will have priority over point changes by replacement or other existing shippers. All these factors adequately protect Tennessee's ability to market its capacity.

23. Tennessee alleges that if points can be upgraded, it cannot make the assurance that shippers will only be restricted when there is maintenance, equipment failure, or other *force majeure* situations that decrease system capacity. The Commission has never required any pipeline to provide firm service that is subject to a prior claim. If the firm primary point capacity is not available, then it cannot be offered. However, if there is firm primary point capacity available, it must be offered to all potential shippers on a non-discriminatory basis, including replacement shippers.

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[20] As a general matter, pipelines are not required to permit segmentation in a situation where the nominations by a shipper or a combination of releasing and replacement shippers exceed the contract demand of the underlying contract on any segment. Order No. 637-A at 30,591.

[21] Process Gas Consumers Group v. FERC, 292 F.3d 831 (D.C. Cir. 2002), aff'g Tennessee Gas Pipeline Co., 94 FERC ¶ 61,097 (2001), 91 FERC ¶ 61,053 (2000).

24. In the event the Commission denies rehearing, Tennessee requests a two-year delay to assess how well Tennessee's proposal works on Tennessee and in comparison to other pipelines' systems and to implement software changes. The Commission has delayed acting on this compliance filing for a year, and is conditionally accepting Tennessee's tariff sheets, to become effective September 1, 2003. Therefore, considerable time has already elapsed. Further, the Commission's finding made no change to Tennessee's currently effective tariff with regard to the awarding of primary points. Tennessee does not dispute it could have rendered firm service, segmentation and pathing if the shipper was a new shipper. Tennessee has provided no evidence that, simply because a release is involved, there is a difference in programing requirements.

c. Other Methods of Acquiring Primary Point Capacity

i. Requests for Rehearing

25. Dynegy states that the Commission accepted Tennessee's method of raising secondary points to primary over Dynegy's and others' protests. Under that method, Dynegy states, a shipper must participate in and successfully be awarded primary point capacity through a net present value open season. Dynegy claims that the Commission should not have compared replacement shippers with shippers seeking new capacity. Rather, Dynegy continues, the Commission should have placed replacement shippers on an equal footing with existing shippers. Dynegy notes that Section 4.7 of Tennessee's Rate Schedule FT-A, which addresses existing customers' rights to substitute primary points, does not require existing shippers to submit new bids or enter an open season. Further, Dynegy wants the elevation process to be quick and easy, as compared to the open season process. Dynegy believes that its requested level of comparability and responsiveness is necessary for replacement capacity to serve as a viable competitive alternative to pipeline capacity.

26. Indicated Shippers argue that the Commission, in accepting Tennessee's tariff as in compliance with Texas Eastern/El Paso, contradicts Order No. 637. In Order No. 637, the Commission stated that "[t]he releasing and replacement shippers must be treated as separate shippers with separate contract demands ... the releasing shipper may reserve primary points on the unreleased segment up to its capacity entitlement on that segment, while the replacement shipper simultaneously reserves primary points on the released segment up to its capacity on that segment."[22] The Indicated Shippers claim that

[22] Citing Order No. 637 at 31,302.

Tennessee's proposal will not result in that result, as Tennessee would require the proportional reduction in the original contract quantity.

ii. Commission Response

27. Dynegy states that the Commission found Tennessee's existing method of raising secondary points to primary points reasonable, and that the Commission should have placed replacement shippers on an equal footing with existing shippers. As discussed above, the Commission is requiring Tennessee to treat replacement shippers seeking to change primary points no differently than existing shippers. Dynegy also argues that the Commission should not have placed replacement shippers on the same footing with shippers seeking new capacity. The Commission, however, is treating replacement shippers no differently than existing shippers under Tennessee's NPV selection process.

28. Dynegy further maintains that Tennessee should be required to process replacement shippers' requests to elect primary points on a faster process than for existing shippers in order to provide a more viable competitive alternative to pipeline capacity. Dynegy has not explained why awarding primary point capacity to replacement shippers should be easier and take less time than with respect to existing (non-replacement) shippers. The same process also has to be used in evaluating requests for new service. The Commission finds that the same non-discriminatory process should be used in processing all requests to change points, and denies Dynegy's rehearing request.

29. Indicated Shippers claim that Tennessee's proposal will not result in segmented capacity with primary points, because Tennessee would require the proportional reduction in the original contract quantity. As discussed above, the Commission rejected Tennessee's proposal on this issue.

d. Overlapping Point Nominations

i. Requests for Rehearing

30. In light of the Court remand of certain issues related to Order No. 637,[23] Tennessee suggests that the Commission simply reverse its decision regarding overlapping point nominations. Tennessee states that the Commission failed to show why the existing tariff conditions are no longer just and reasonable. The Commission has

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[23] Interstate Natural Gas Association of America v. FERC, et al., 285 F.3d 18 (D.C. Cir. April 5, 2002) (INGAA).

since issued its *Order on Remand*, and Tennessee has filed in compliance in Docket No. RP03-183-000. The Commission will address Tennessee's compliance filing below.

31. As for the issue of financial impact, Tennessee alleges that the April 3 Order mischaracterized Tennessee's example. Tennessee's example showed a shipper that needed delivery of 40,000 dth per day and contracted for that amount. The Commission's change, Tennessee alleges, would permit the shipper to contract for half that capacity due to changes in market demand, but still take the same amount of gas. This, Tennessee claims, is forcing Tennessee to provide service without the ability to properly charge for it. Tennessee claims that the Commission's failure to address this harm is in error. Tennessee states that this is not an operational issue, but an issue of contract modification. Under the Commission's ruling, a shipper will be able to schedule as firm service double the contracted capacity at a delivery point and only pay the commodity rate.

32. The New England LDCs support the April 3 Order with regard to overlapping point nominations. However, they claim that the April 3 Order ignored its request that the finding also apply to service on laterals. They request that lateral lines be treated the same as any other delivery point on the mainline.

ii. Commission Response

33. Contrary to Tennessee's assertions, the Commission properly found that Tennessee must permit a shipper to use a forwardhaul and backhaul to the same delivery point even if that amount exceeds its mainline contract demand. After Tennessee filed the instant rehearing request, the United States Court of Appeals for the District of Columbia Circuit issued its decision in INGAA, remanding certain issues to the Commission regarding Order No. 637. In its *Order on Remand*, the Commission concluded that it may require pipelines to permit backhauls and forwardhauls to the same point, each of which is up to the shipper's contract demand, by making the necessary findings under NGA Section 5 to require the pipeline to revise its terms and conditions to permit such backhauls and forwardhauls. The Commission further determined that it is not requiring pipelines to permit the shippers to use the primary point rights defined by its contract demand beyond those set forth in the contract.

34. The Commission went on to make the necessary Section 5 determination that failure to permit such a segmented transaction where operationally feasible is unjust and unreasonable because it restricts efficient use of capacity without adequate justification. Permitting this type of transaction is just and reasonable because it creates additional supply alternatives for shippers and enhances competition on the pipeline's system.

35. The issue of overlapping point nominations is not an issue of contract modification as suggested by Tennessee. A shipper is not able to double its contract primary capacity rights. Under Tennessee's example the shipper would be entitled to only 40,000 dth per day in primary capacity rights, therefore the shipper's primary capacity rights are not increased. Any backhaul transaction would have to be on a secondary basis.

36. Tennessee is not required to permit transactions that result in shippers exceeding their contract demand on laterals. In Algonquin, the Commission rejected a request to permit overlapping forwardhaul in excess of contract demand along a lateral to a shipper's delivery point on that lateral to the extent necessary to complete non-overlapping segmented forwardhaul and backhaul transactions on the mainline.[24] The Commission found that this would be inconsistent with Order No. 637 which states that segmentation cannot exceed a shipper's contract demand in any segment. However, where there is no overlap on the lateral or mainline but the transactions only use the same point, the two transactions must be permitted.

2. Mainline Priority at Secondary Points

a. April 3 Order

37. Order No. 637-A provides that each pipeline must afford a higher priority over mainline capacity to shippers seeking to use a secondary point within their capacity path than shippers seeking to use mainline capacity outside of their path, unless the pipeline can demonstrate that such an approach is operationally infeasible or leads to anti-competitive outcomes on its system.

38. The April 3 Order accepted Tennessee's secondary point priority restriction model for capacity path. The model starts with the premise that all within-the-path and within contract demand quantity secondary point nominations should have a priority over out-of-path firm and interruptible service nominations. While a shipper’s contract primary points determine its capacity path, the secondary priority level of any particular secondary point, within or outside of the path, is based on whether that transaction is moving gas through a pipeline capacity restriction. If a restriction is in the shipper’s capacity path, then the flow will be considered at the higher secondary priority level. If the restriction is outside the shipper’s capacity path but within the nominated path, then the flow will be at

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[24] Algonquin Gas Transmission Co., 98 FERC ¶ 61,211 at 61,774-5 (2002) (Algonquin). See also East Tennessee Natural Gas Company, 103 FERC ¶ 61,237 at P 37 (2003).

a lower secondary priority level. The "restriction model" also separately ranks secondary points. Secondary points within-the-path are scheduled first, followed by secondary points outside the path. Secondary points are scheduled after primary points.

b. Request for Rehearing

39. Clarksville claims that the Commission, in approving Tennessee's proposal, rejected without explanation requests to assure a higher scheduling priority for those segments with secondary receipt points and primary delivery points over segments with primary receipt and secondary delivery, or both points with a secondary status. The New England LDCs also claim that the April 3 Order ignored its position that any segment with a primary point should receive a higher scheduling priority. The New England LDCs and Clarksville claim this requirement is necessary to service critical requirements and basic human needs behind the city gate. Clarksville and the New England LDCs claim primary point scheduling priority accommodates the need to change receipt points as supply sources change, prices for supply change, and cutoffs take place. Clarksville also believes that acceptance of the new priorities reneges on a fundamental guarantee of Order No. 636 to small captive customers that no-notice service would be as reliable as bundled sales service. As these customers were required to give up general system primary receipt points and replace them with specified primary points, Tennessee's new priority scheme degrades the service small customers will receive. The New England LDCs also note that the Commission accepted such a priority method in Texas Eastern over the objections of some parties.[25] The New England LDCs request that the Commission apply the Texas Eastern precedent to Tennessee.

c. Commission Response

40. Contrary to Clarksville's and New England LDCs' contentions, the Commission did address their requests.[26] Order Nos. 637-A and 637-B did not mandate a specific order of priority to allocate capacity between shippers that are either within or outside the path. The Commission did not, for example, specify whether a shipper moving from a secondary receipt point inside its path to a primary delivery point should have priority over a shipper moving from a primary receipt point to a secondary delivery point inside its path. Thus, to the extent there are scheduling conflicts over two secondary within-the-path transactions, the pipeline is free to choose any reasonable method of resolving such a

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[25] Citing Texas Eastern Transmission, L.P., 98 FERC ¶ 61,215 at PP 49, 52 (2002) (Texas Eastern).

[26] 99 FERC ¶ 61,017 at P 88 (2002).

conflict. The Commission's finding in the April 3 Order is consistent with Texas Eastern, wherein the Commission found Texas Eastern's proposal, which was different from Tennessee's, also achieved the required objective of providing within the path priority.

41. Moreover, those seeking rehearing have not shown that Tennessee's scheduling priority will be of much practical significance for within-the-path transactions. As long as the shipper has reserved the capacity path, there should be sufficient capacity for both transactions to flow as long as the shippers have the necessary injection or take-away rights on the upstream and downstream entities. For instance, if the pipeline has two shippers each with contract demands of 10,000 Dth/day, and both shippers use a secondary receipt point within their path and both use a primary delivery point, the pipeline has sufficient capacity to serve both shippers, because at no point does the total contract demand exceed 20,000 Dth/day. Accordingly, the requests for rehearing are denied.

3. Tertiary Capacity Rights

a. April 3 Order

42. Under Tennessee's tariff, Tertiary Capacity shippers have the right to nominate above their contract quantities for a specific leg on Tennessee's system, but within their overall contract quantity, without additional charge. NICOR and Indicated Shippers argued that Tennessee should not be allowed to eliminate Tertiary Capacity rights that allow shippers to exceed on a firm basis contractual entitlements in a particular supply leg. The April 3 Order interpreted Tennessee's proposal such that over-nominations on a leg would be considered out of the path and above contract entitlement, and could be subject to an additional transportation charge. Further, the April 3 Order found that Tennessee's supporting statement that Tertiary Capacity rights are redundant, was incomplete and does not satisfactorily explain why tertiary capacity rights need to be terminated. The April 3 Order rejected Tennessee's proposal to remove Tertiary Capacity rights.

b. Request for Rehearing

43. Tennessee argues that the Commission was in error when it rejected Tennessee's proposal to simplify its priority scheme by removing tertiary priority and permitting those nominations to have secondary out of path priority. Tennessee states that its proposal would raise the priority of these out of the path nominations, and would not result in any new or changed transportation rates or charges. In the alternative, if the Commission intended that tertiary shippers should not be allowed secondary out of path priority,

Tennessee requests that the Commission grant rehearing and not require that these shippers receive lower priority than secondary out of path.

c. Commission Response

44. Tennessee clarifies that no new or changed transportation rates or charges would be assessed as the result of elevating tertiary priority to secondary out of path priority. Tennessee also clarifies that service currently prioritized as tertiary would be categorized as secondary out of path. As such, NICOR and the Indicated Shippers concerns that shippers may exceed on a firm basis contractual entitlements in a particular supply leg are misplaced. As there is no rate impact or change in primary firm service obligation by this proposal, the Commission grants rehearing and accepts Tennessee's proposal.

4. Discount Provisions

a. April 3 Order

45. In Order No. 637-A, the Commission stated that the current policy permitting pipelines to limit discounts to particular points needs to be reexamined in the compliance filings, as part of the examination of restrictions on capacity release and segmentation.[27]

46. The Commission required Tennessee to comply with the discount policy established in CIG/Granite State.[28] The Commission adopted a new policy that permits a shipper to retain a discount when it moves to segmented points or secondary points through a streamlined request process in which the pipeline processes requests for discounts within two hours.

b. Requests for Rehearing

47. Tennessee states that the April 3 Order's directive to modify its tariff provisions governing discounts without making the requisite findings and stating the reasons why the policy should apply violates NGA Section 5. Moreover, Tennessee contends that the

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[27] Order No. 637-A, FERC Stats. & Regs. Regulations Preambles (July 1996-December 2000) ¶ 31,099 at 31,595.

[28] Colorado Interstate Gas Company, 95 FERC ¶ 61,321 (2001) (CIG); Granite State Gas Transmission, Inc., 96 FERC ¶ 61,273 (2001), reh'g denied, 98 FERC ¶ 61, 019 (2002) (CIG/Granite State).

Commission's new discount policy represents an unwarranted and unjustified interference with established contracts and should apply only prospectively. Tennessee believes that the CIG/Granite State policy eliminates Tennessee's ability to limit firm discounts. Tennessee and Clarksville state that these required new discounts may have potential negative consequences to maximum rate paying customers, because maximum rate customers will have to subsidize the additional discounts through discount adjustments to Tennessee's approved maximum rates. This is especially true when the discount evaluation for firm shippers must take into consideration similarly situated interruptible transportation discounts.[29] Tennessee argues that equating firm service with interruptible service is a complete reversal of longstanding Commission policy.

48. Tennessee also objects to the 2-hour response time. Tennessee states that the Commission failed to meet its NGA Section 5 burden as to why this burdensome and costly requirement is feasible, cost effective and beneficial. Tennessee suggests that, in order to perform this analysis, a shipper should be required to explain where it contemplates using different points and why it is similarly situated to discount customers at those points and how long it wants the discount. Tennessee continues that it needs three days to evaluate the request and to respond.

49. The Indicated Shippers, while generally supporting the Commission's finding, argue that the CIG/Granite State policy is partially flawed. Under the CIG/Granite State policy, shippers may retain their primary point discount at secondary points, with the exception that they must pay the higher of the contract or discounted rate. The Indicated Shippers believe this results in rates that are unduly discriminatory and anti-competitive. Indicated Shippers contend that the portable discount should be based on the rate that the similarly-situated incumbent shipper is paying.

c. Commission Response

50. Under the CIG/Granite State policy, there is a rebuttable presumption that a shipper holding a discount at a point will retain a discounted rate if it chooses to segment, release capacity, or use its flexible receipt and delivery point rights to move gas to another point at which the pipeline has granted discounts for its firm or interruptible transportation service. The pipeline can rebut this presumption by showing that the segmented or secondary point transaction is not similarly-situated to the transactions receiving the discount at the secondary point.

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[29] Citing Gulf South Pipeline Co., L.P., 98 FERC ¶ 61,278 (2002).

51. Tennessee argues that the Commission failed to meet its burden of proof under Section 5 that Tennessee's existing discount tariff provisions are no longer just and reasonable and the Commission's new discount policy is just and reasonable for Tennessee when the Commission imposed its new discount policy on Tennessee. The Commission, in applying the CIG/Granite State discount policy to Tennessee, was acting in compliance with NGA Section 5. The Commission has adopted the CIG/Granite State discount policy in furtherance of its policy of enhancing competition. The Commission found that allowing discounts to be limited to specific points was unjust and unreasonable, because it reduced competition and was unduly discriminatory insofar as it treated similarly situated shippers at the same point differently. The Commission's discussion in the April 3 Order fully explained the reasoning behind the discount policy.[30] The policy allows shippers using flexible point rights to compete with the firm and interruptible services offered by the pipeline and with other shippers holding contracts for capacity at the flex points. A shipper which uses flexible point rights to move to a secondary point or segment its capacity will require the use of different points than the primary points contained in the contract. If that shipper is always subject to paying the maximum rate, competition will be restricted.[31] Furthermore, a pipeline may rebut the presumption under the policy. This new policy is applicable to all pipelines. Tennessee has not shown or even suggested why the policy should not be applied to it.

52. In its rehearing request Tennessee argues that the discount policy must be applied prospectively, and that the Commission should not change the terms of any existing agreements. The Commission's policy is applied prospectively to shippers under existing discount agreements when those shippers seek to use secondary points. We disagree the policy should not apply to shippers under existing contracts using secondary points. Applying the policy to existing contracts prevents undue discrimination towards existing shippers. The CIG/Granite State policy merely grants shippers using an alternate point the right to be treated the same as similarly situated shippers at the same point. In those cases where the shipper pays a lower rate than the price offered at the secondary point, the shipper changing points can only receive a rate equal to the discount rate offered at the secondary point.[32] Accordingly, provisions in Tennessee's tariff or in its contracts that are inconsistent with the Commission's CIG/Granite State policy are unjust and unreasonable.

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[30] 99 FERC ¶ 61,017 at PP 105-110 (2002).

[31] CIG, 95 FERC ¶ 61,321 at 62,120-21 (2001).

[32] In those cases, where no discount is offered to a similarly situated shipper at the alternate point, the shipper must pay the maximum rate to use the alternate point.

53. In CIG,[33] the Commission held that the rebuttable presumption applied to points where the pipeline has granted discounts for its firm or interruptible transportation services. Tennessee argues that the CIG/Granite State policy may limit its ability to limit firm discounts, especially when the discount evaluation for firm shippers must take into consideration similarly situated interruptible transportation discounts. Tennessee's ability to limit firm discounts may be curtailed somewhat by the Commission's new discount policy. However, the pipeline's loss of discretion is outweighed by the need to prevent undue discrimination and promote competition.

54. Tennessee also argues that equating firm and interruptible service is a reversal of Commission policy. We disagree. The Commission has not stated that firm and interruptible shippers are always similarly situated. It has only held that a mere difference in service is not enough by itself to justify a finding that the two shippers are not similarly situated.[34]

55. In Order Nos. 636 and 637, the Commission held that a primary purpose of its capacity release program is to promote increased competition by allowing firm shippers to release their capacity in competition with the pipeline's interruptible service. If the fact that a shipper in a capacity release is receiving firm service would always mean that it was not similarly situated to a shipper receiving interruptible service from the pipeline, pipelines would never consider capacity release transactions similarly situated to the pipeline's interruptible service. That would mean that a releasing shipper with a discount at one point would always lose its discount when it sought to release capacity in competition with a pipeline's sale of interruptible service using another point. This would discourage such releases and undercut the Commission's competitive goals. There may be times when a capacity release is not similarly situated to the pipeline's interruptible service and the presumption of similarity can be rebutted. For example, if the releasing shipper sells capacity on a non-recallable basis for a full year on a portion of the pipeline where interruptible service is often interrupted, the two services may well not be similar. But if the releasing shipper sells capacity for a month, the release transaction may well be similar to interruptible service sold by the pipeline.

56. Tennessee and Clarksville argue that the CIG/Granite State discount policy may adversely Tennessee's maximum rate customers through discount adjustments to Tennessee's maximum rate. They have not demonstrated that there will be any significant

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[33] 97 FERC ¶ 61,011 at 61,048 (2001).

[34] CenterPoint Energy-Mississippi River Transmission Corp, 102 FERC ¶ 61,216 at P 26 (2003).

impact on the maximum rate customers. The revenue Tennessee derives from the flexed contract remains unchanged. Under the CIG/Granite State policy, when shippers change points, the pipeline charges the higher of the contract rate or the discounted rate. Thus, the pipeline will not receive less revenue from the shipper changing points than it already receives. It is possible that in some situations, a shipper would have changed points and paid the maximum rate for such a change.[35] Such revenue, however, would enure only to the pipeline unless the revenue happened to be generated during the test period of a rate case, in which case it might reduce the ongoing rate for existing customers assuming that such revenue is sufficiently projectible to the future. However, as the Commission found in CIG, allowing the pipeline to require shippers changing points to pay the maximum rate serves to inhibit competition and is unduly discriminatory. In balancing the remote possibility that existing customers may receive reduced rates from shippers paying the maximum rate to change points against the harm to competition and the requirement for non-discriminatory treatment, the Commission finds that the balance weighs far more heavily on the side of competition and non-discrimination.

57. The Indicated Shippers argue that all similarly situated shippers at the same point should receive the same rate. We reject Indicated Shippers argument because the issue here is whether shippers can retain discounts when using secondary points, not whether shippers can abrogate existing service contracts. As discussed above, under the Commission's policy, when a shipper with a discounted rate seeks to use secondary points, it is entitled to retain its discount so long as similarly situated shippers receive discounts equal to or greater than the shipper's discount. In those cases where the shipper pays a lower rate than the price offered at the secondary point, the shipper changing points can receive a rate equal to the discount rate offered at the secondary point. Adopting Indicated Shippers' position would grant a shipper more than its contract rights. The shipper has signed a contract for service at a particular rate, and using a secondary point does not entitle the shipper to modify or abrogate its existing contract to obtain a rate lower than its contractual rate. Indeed, such a requirement could result in the pipeline being unable to recover its cost of service, which is based on shippers paying their contract rates.[36] Thus, the Commission will not change its policy.

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[35] Of course, it is equally possible, as the Commission found, that having to pay the maximum rate for changing points would discourage the release and point change.

[36] When shippers pay the maximum rate under their contract, under Order No. 636, they continue to pay the contractual maximum rate when using alternate points regardless whether the pipeline has given someone else a discount at the alternate point. Indicated Shippers has provided no justification for giving shippers with discounted rates

(continued...)

58. Tennessee further requests that the Commission permit three days of additional time for it to process segmented capacity discount requests. The Commission has recognized that pipelines may not have sufficient staff to process discount requests overnight. Therefore, pipelines must act on overnight requests to retain discounts received by 4:00 p.m. no later that 8:30 a.m. CCT the next business day and need not process requests on weekends. See National Fuel.[37]

5. Penalties

a. April 3 Order

59. Tennessee currently has a daily scheduling variance penalty mechanism under Rate Schedules LMS-MA and LMS-PA.[38] Tennessee's currently effective Rate Schedule LMS-MA also includes a penalty of $15/Dth plus the applicable regional daily spot price for customers who exceed the Maximum Allowed Volume (MAV) by 2 percent or more. Tennessee's current tariff also provides for Tennessee to charge penalties under Rate Schedule PAL, storage related penalties under Rate Schedules IS and FS, an unscheduled flow penalty, and two levels of OFO penalties (an Action Alert penalty which is twice the currently effective daily variance penalty for gas volumes deviating from the Action Alert tolerance and a Balancing Alert penalty of $15/Dth plus the applicable daily regional spot price for gas volumes deviating from the OFO requirement.

60. The April 3 Order accepted Tennessee's proposal to (1) eliminate the unauthorized overrun charge and replace it with an OBA Transportation Service (OTS), and (2) replace the daily scheduling variance charge with a Daily Imbalance provision and a Daily Imbalance Charge. Tennessee proposed no changes to its PAL penalties, storage penalties, or unscheduled flow penalty. However, as discussed in the compliance section of this order below, the April 3 Order required Tennessee to revise these penalty provisions. The April 3 Order accepted Tennessee's proposed additional OFO medium level penalty tier designated as Critical Day. However, the April 3 Order rejected

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[36](...continued)
preferential treatment by allowing them to reduce their rate below the rate specified in their contract.

[37]National Fuel Gas Supply Corp., 98 FERC ¶ 61,123 (2002) (National Fuel).

[38]LMS-PA and LMS-MA stand for Load Management Service - Pooling Area and Market Area, respectively. In practical terms, LMS-PA establishes an OBA for receipt point operators, and LMS-MA establishes an OBA for delivery point operators.

Tennessee's proposal to increase the Balancing Alert penalty from $15/Dth to $25/Dth plus the applicable spot price. The OFO penalties are discussed below in a separate section.

b. Daily Imbalance Charge[39]

61. Tennessee has proposed to totally redesign its scheduling imbalance penalty. Because of the differences between the existing daily variance charge and the proposed Daily Imbalance Charge, a direct comparison between the two penalties cannot be made. The current daily variance penalty applies only when Tennessee provides notice to an operator.[40] The daily variance penalty applies to daily netted scheduling variations greater than 10 percent of scheduled volumes, but below the Maximum Allowed Volume (MAV), 5 percent under Rate Schedule LMS-MA if the OBA is for 300,000 dth. The penalty may be assessed without regard to the net pipeline imbalance position (the difference between the net quantities scheduled and actual flow).[41] The daily variance penalty is $0.3936 for Rate Schedule LMS-MA and $0.1099 for Rate Schedule LMS-PA.

62. The proposed Daily Imbalance Charge would work as follows. The penalty will apply only on each day on which the net pipeline imbalance position exceeds 5 percent of scheduled volumes under both Rate Schedules LMS-PA and LMS-MA,[42] and will apply only to a balancing party with an imbalance greater than 10 percent of scheduled volumes in the same direction as the pipeline imbalance. The Daily Imbalance Charge is two times the Rate Schedule PAL rate ($0.3695 per dth) for imbalances greater that 10 percent but less than or equal to 20 percent and four times the Rate Schedule PAL rate for imbalances greater that 20 percent. This will be a one-time charge for a particular day’s imbalance.

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[39] Although the Commission considers this an OFO penalty, the parties requesting rehearing raised their issues in the context of non-OFO penalties. Therefore, the Commission will address their rehearing requests here as opposed to the following OFO section.

[40] Eight hours notice pursuant to Sections 4 and 7(b)(iii) of Rate Schedule LMS-MA, and two days pursuant to Section 5(c) of Rate Schedule LMS-PA.

[41] Section 7(b)(iv) of Rate Schedule LMS-MA, and Section 5(c) of Rate Schedule LMS-PA.

[42] Imbalance data will be adjusted for any imbalance service used by the point operators, such as SSO, and Tennessee will provide a continuous notice on its PASSKEY website of the system imbalances.

63. For each day, all revenues collected pursuant to the above mechanism will be credited, net of costs, to Eligible Parties. Eligible Parties will be defined as balancing parties under Rate Schedules LMS-PA or LMS-MA, as applicable, with an imbalance that is within plus or minus 5 percent of scheduled volumes. Credits will be allocated to the Eligible Parties' accounts based upon the scheduled volumes under the applicable balancing agreement for the day in which the charges were in effect. The daily credits will be aggregated and disbursed to the Eligible Parties annually.

64. Thus, the Daily Imbalance Charge: (1) rewards parties that stay within 5 percent of scheduled volumes; (2) is only applied to parties who exceed the existing 10 percent tolerance and exacerbated the system imbalance; and (3) is only charged when the system is stressed by being more than 5 percent out of balance and providing firm service is at risk. Moreover, the Daily Imbalance Charge incorporates inherent netting of imbalances as the charge is only in effect when netting fails to keep the system as a whole within a 5 percent imbalance. Rate Schedule LMS point operators can still fully trade the actual gas imbalances.

i. **Requests for Rehearing**

65. Dynegy and NEG Shippers claim that the Commission's reasoning in accepting the Daily Imbalance Charge is inconsistent with past precedent, and the Daily Imbalance Charge should be revised. NEG, Dynegy, the Indicated Shippers, and the New England LDCs claim Tennessee acknowledged that it provided no evidence that its currently effective daily variance charge is no longer adequate, or that the new system is tailored to address operational integrity issues. The New England LDCs also challenge Tennessee's claim that it lacks the assets to manage system imbalances, or that the 10 percent imbalance level for individual shippers or 5 percent on a system-wide basis are problematic. NEG, Dynegy, the Indicated Shippers, and the New England LDCs claim that Tennessee must demonstrate the necessity for such a change. Dynegy, the Indicated Shippers, and NEG Shippers claim that in reviewing other proposals to modify penalty provisions the Commission consistently required a showing of the necessity for changes, and rejected proposals that failed to identify operational problems directly attributable to the existing tariff provisions. Further, Dynegy and NEG Shippers allege that the Commission rejected a similar daily imbalance penalty as an inappropriate proposal in an Order No. 637 compliance filing.[43]

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[43]Citing Southern Natural Gas Co., 99 FERC ¶ 61,042 at 61,163 (2002). See also Texas Eastern, L.P., 98 FERC ¶ 61,215 (2002) and Algonquin Gas Transmission Co., 98

(continued...)

66. Noting that the Commission has said that Order No. 637 proceedings are not the place to make penalty provisions more stringent, Dynegy and the Indicated Sippers claim that Tennessee's proposal is more stringent than the existing provision. They claim that, whereas the existing daily variance charge is tied to system integrity, the proposed Daily Imbalance Charge applies regardless of the actual status of Tennessee's system. NEG Shippers and Dynegy also question the timeliness and quality of imbalance data Tennessee will provide for the purposes of imbalance management. NEG Shippers request that the Commission require Tennessee to provide real time data and stand behind that data. The Indicated Shippers request one gas day prior notice before application of the imbalance charge and an increase of the tolerance to 20 percent.

67. NEG Shippers also claim that the Daily Imbalance Charge is excessive. NEG Shippers note that the Commission typically approves twice the IT rate, whereas the Daily Imbalance Charge is four times the Rate Schedule PAL rate. The Indicated Shippers argue that the Commission's proper rejection of Tennessee's proposed increase to the Balancing Alert penalty stands in sharp contrast to the approval of the increased Daily Imbalance Charge.

68. Clarksville and the New England LDCs argue that the Commission ignored their request that, to protect small customers, the Commission require tolerances expressed in absolute terms. Clarksville notes that Tennessee responded to its request, and did not oppose it. Clarksville requests that Tennessee establish a tolerance that is the greater of 10 percent of scheduled volumes or 1,000 Dth. Clarksville notes that the 1,000 Dth minimum is currently part of Tennessee's tariff. The New England LDCs suggest an absolute tolerance level of 500 Dth. Moreover, New England LDCs request that Tennessee provide at least two hours notice that the Daily Imbalance Charge may be imposed, as opposed to the requirement that customers monitor Tennessee's website.

ii. Commission Response

69. On rehearing, the parties oppose Tennessee's proposed Daily Imbalance Charge for numerous reasons: (1) the proposed charge is excessive; (2) the proposed charge is more stringent than the existing daily variance penalty; (3) acceptance of the proposed charge is inconsistent with Commission precedent; (4) Tennessee has not demonstrated the need for a change in the existing penalty provision; (5) the proposed tolerance level should be increased to 20 percent; (6) small customers should be protected by inclusion of an

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[43](...continued)
FERC ¶ 61,211 (2002).

absolute tolerance level; and (7) the notice period prior to imposition of the proposed charge needs to be changed.

70. Some parties claim that Tennessee's Daily Imbalance Charge is excessive and more stringent than other approved penalties. However, Tennessee's proposal for the Daily Imbalance Charge was part of an overall reassessment of its penalty structure, which included elimination of several penalties (the MAV and unauthorized overrun charge), so that the penalties under the Daily Imbalance Charge cannot simply be compared with the prior daily variance charge. Moreover, as described above, the design of the proposed Daily Imbalance Charges is also different from the existing daily variance penalty so one cannot simply compare the penalty levels. The Commission has reviewed the Daily Imbalance Charge and finds that on balance, the changes benefit the shippers and the penalty is just and reasonable.

71. Under the existing daily variance charge, Tennessee can impose the charge whenever it determines that assessment of the charge is sufficient to avoid jeopardizing system integrity or a threat to its ability to provide firm service. However, the determination is purely at Tennessee's discretion. The proposed Daily Imbalance Charge removes Tennessee's discretion, and provides that the charge applies only if the net pipeline imbalance position exceeds 5%.[44] Tennessee further would only impose the Daily Imbalance Charge when the shipper's imbalance is in the same direction as the system-wide balance. In contrast, when invoked, the daily imbalance penalty would be charged for all variances regardless of whether they are in the same or opposite direction of the pipeline's imbalance. Tennessee also proposes to credit the Daily Imbalance Charge to parties who stay within a 5 percent swing tolerance, which provides a financial incentive for parties to stay more in balance.[45] This too is not part of its current daily imbalance penalty provision. Under both the existing daily variance penalty and the proposed Daily Imbalance Charge the tolerance level for an individual point operator is

[44]The Daily Imbalance Charge, therefore, removes Tennessee's ability to impose a imbalance penalty in a discriminatory fashion.

[45]Accordingly, parties that are no more than 5 percent out of balance do not pay the Daily Imbalance Charge and they are credited the amounts Tennessee collects from those subject to the charge. Parties that are more than 5 percent out of balance, but not more than 10 percent out of balance, do not pay the Daily Imbalance Charge. However, they are not credited the amounts Tennessee collects from those subject to the charge. Parties more than 10 percent out of balance pay the Daily Imbalance Charge and do not receive a credit.

generally 10 percent of scheduled quantities.[46] But Tennessee actually imposed an even narrower 5% tolerance level under the daily variance penalty for an OBA of 300,000 Dth. Moreover, the adoption of the Daily Imbalance Charge is part of an overall revision of Tennessee's penalties in which Tennessee eliminated its MAV penalty of $15/Dth plus the applicable regional daily spot price.

72. Even though the proposed Daily Imbalance charge appears on its face to be higher than the existing daily variance charge, the Commission finds that, in the overall context of Tennessee's penalties, the daily imbalance charge benefits Tennessee's customers and is reasonable. Tennessee's discretion to invoke the penalty has been eliminated (the penalty can be applied only when the system is out of balance by 5%). The penalty can only be imposed when the point operator's imbalance is in the same direction as the system. Tennessee has eliminated the 5% penalty tier for certain point operators and provides operators with the ability to reduce penalties even further by receiving penalty credits whenever they are less than 5% out of balance. Finally, Tennessee has eliminated the $15 MAV penalty, and, in the context of its system, the use of a penalty above its PAL rate is a reasonable method of providing operators with an incentive to limit their imbalances.[47]

73. While Order No. 637 did not allow pipelines to increase penalties, it did encourage the review of penalty design with the objective of introducing more imbalance management services and penalty structure focused on operational integrity. The Commission finds that the proposed Daily Imbalance Charge is part of a package of changes to Tennessee's penalty structure that satisfies these objectives, is beneficial to shippers, and is just and reasonable. For example, Tennessee proposes to eliminate its existing MAV penalty structure and replace it with an OBA Transportation Service, eliminate its existing unscheduled flow penalties, and add additional OFO tiers so it will not have to impose the most stringent OFO penalty as often. Further, Tennessee offers a number of imbalance management options and shippers may avoid the Daily Imbalance Charge by using one of these options such as Tennessee's PAL service.

[46]Five percent under the current daily variance charge, if the Rate Schedule LMS-MA OBA is for 300,000 dth. Tennessee proposes to eliminate this lower tolerance exception and apply the Daily Imbalance Charge to all OBAs with deviations greater than 10 percent.

[47]Point operators can use the PAL service to avoid an imbalance penalty, and, therefore, it is reasonable for the penalty rate to be higher than the rate shippers can pay to avoid the penalty.

74. Contrary to the claims on rehearing, the Commission finds that the Daily Imbalance Charge is designed to prevent the impairment of reliable firm service. As stated above, the charge is imposed only when the imbalance contributes to the system-wide imbalance and the net pipeline imbalance exceeds 5 percent. The penalty is a graduated penalty which increases as the point operator's imbalance increases. Additionally, Tennessee has stated that a 5 percent system-wide imbalance represents its operational limit to manage imbalances and presented data indicating that shippers are not making a sustained and consistent effort to stay in balance. Tennessee has designed the Daily Imbalance Charge to focus on the points that are contributing the most to the system-wide imbalance. We find that Tennessee has sufficiently demonstrated that it needs to address shipper imbalances on its system and its proposed penalty to address the operational needs of Tennessee's system is an improvement over the existing penalty provisions. Therefore, Tennessee has adequately justified the proposed change from the existing daily variance penalty to the Daily Imbalance Charge. On rehearing parties have provided no evidence to dispute the operational evidence provided by Tennessee. Indicated Shippers have presented no evidence to demonstrate that an increase in the individual tolerance level to 20 percent of scheduled volumes will meet the operational needs of Tennessee's system. Thus, Indicated Shippers have not met the burden of demonstrating that their proposed change is just and reasonable.

75. Clarksville and the New England LDCs request that tolerance levels be expressed in absolute terms to protect small customers. Under Tennessee's currently effective daily scheduling variance penalty Tennessee would assess a penalty for imbalances greater than 10 percent of scheduled volumes or 1,000 Dth (the daily scheduling variance penalty in Rate Schedule LMS-MA includes the language "not to exceed the parties maximum allowed volume...." which is not included in Rate Schedule LMS-PA). Under Tennessee's proposed Daily Imbalance Charge, it has retained the 10 percent tolerance level, but eliminated the absolute tolerance of 1,000 Dth. As 10 percent of scheduled volumes under a large OBA can equate to as much as 30,000 Dth,[48] Tennessee has not demonstrated why it is operationally necessary to eliminate the exemption from penalties for those OBAs whose imbalances do not exceed 1,000 Dth. Therefore, Tennessee is required, within 30 days of the issuance of this order, to file revised tariff sheets providing that the tolerance level for the Daily Imbalance Charge for balancing parties is 10 percent of scheduled volumes or 1,000 Dth or provide an explanation why it can no longer provide for such an absolute tolerance level for small customers.

[48] Rate Schedule LMS-MA's Section 2(a) limits single point OBA's to 300,000 Dth.

76. The Indicated Shippers request a one day notice and the New England LDCs request a two-hour notice prior to the application of the Daily Imbalance Charge, so that customers will not have to continually monitor Tennessee's website. The Commission rejects the Indicated Shippers' proposal, as a one-day notice for a penalty that is based on daily operational conditions would negate the penalty. We also reject the New England LDCs' request for a two-hour notice. The New England LDCs proposal would convert a penalty based on a daily calculation to an hourly calculation, since the penalty would apply two hours from the notice. This would require that Tennessee have data on a real-time, point-by-point basis. Tennessee has not indicated that it has this capability. Nonetheless, the Commission agrees that shippers should be given reasonable notice that the system is entering conditions which may cause Tennessee to assess Daily Imbalance Charges. This notice does not tell the shippers that they definitely will be subject to penalties. That is a function of the final daily imbalance position of the point the shippers deliver to or receive from, and their agreements with the point operators. However, with such notice shippers will have the option of bringing their performance within scheduled quantities or making intra-day nominations to avoid imbalance penalties. Accordingly, Tennessee is directed to file, within 30 days of this order, revised tariff sheets providing that Tennessee will give shippers, including point operators, notice when its net system imbalance is approaching 5 percent that it may assess Daily Imbalance Charges.

c. Cash-Out Mechanism

i. April 3 Order

77. The April 3 Order did not require any modifications to Tennessee's effective cash-out mechanism.

ii. Request for Rehearing

78. The Indicated Shippers believe that the combined impact of Tennessee's existing imbalance cash-out mechanism with the Daily Imbalance Charge and other OFO penalties was not examined or justified by the April 3 Order. The Indicated Shippers believe that the failure to examine the combined impact of the penalties is contrary to Order No. 637 and is not reasoned decision making.

iii. Commission Response

79. The Commission denies rehearing. Tennessee did not propose any changes to its existing cash-out mechanism. Furthermore, as discussed above, the Commission finds that Tennessee's proposed Daily Imbalance Charge provisions are in compliance with

Order No. 637. The Indicated Shippers did not raise any complaints against the specific cash-out mechanism. Furthermore, contrary to Indicated Shippers' contention, the Commission has considered the combined impact of Tennessee's penalty provisions, and finds that there is no need to require any modifications to Tennessee's imbalance cash-out mechanism. The fact that the discussion in the April 3 Order individually considered Tennessee's proposed penalties does not mean that it did not consider the combined impact of the proposed penalties. It is clear from the Commission's discussion in the OFO penalty section of the April 3 Order that the Commission considered the combined impact of Tennessee's proposed penalties.[49]

6. OFOs

a. April 3 Order

80. The April 3 Order accepted several proposed changes that increase the number of graduated OFO levels available to Tennessee from three to five. Tennessee will only call a Critical Day One and Two for a discrete part or all of its system if certain conditions exist. Those conditions are when customers are in contravention of a capacity curtailment restriction, or when Tennessee’s operational storage falls below 10 percent of the required total storage balance or exceeds 90 percent of the required total storage balance, or loss of or an inability to maintain line pack. In the compliance filing conditionally accepted in this order, Tennessee proposed to notify customers of the issuance of OFOs, including Critical Days OFOs, via telephone as well as internet notification.

81. Tennessee proposed to require, as part of the operational flow order, adjustments to deliveries and receipts "in uniform hourly quantities during the day." The Commission noted that the required action provisions are usually limited to staying within contractually provided limits, including staying within daily scheduled limits. If system operations are such that firm service cannot be reliably provided, Tennessee has other provisions in its tariff, such as curtailment and force majeure, that address these situations. The Commission required Tennessee to either remove the uniform hourly flow requirement, or limit it to those services that are subject to the requirement under the terms of their rate schedule.

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[49] Tennessee, 99 FERC ¶ 61,017 at PP 244-46 (2002).

b. Requests for Rehearing

82. Dynegy requests rehearing. Dynegy and Clarksville believe that a decrease in operational storage cannot be considered a situation of urgency. Dynegy believes this provision should be coupled with a qualifying provision of a threat to system integrity or firm service.[50] Clarksville claims that the "to forestall the deterioration of operational conditions on its system" condition is so vague as to be no standard at all for calling Critical Days, and the third condition of loss and line pack maintenance is undefined. While Tennessee retained its Action Alert OFO with a 48-hour notice, Clarksville argues that does not provide a reasoned basis for the Critical Day notice period. The Dominion LDCs recommend a 24-hour notice as it provides adequate time to reschedule supply and time for Tennessee to address less serious operational problems.

83. Dominion LDCs note that prior to the April 3 Order, the Commission stated that pipelines should provide back-up means of communication.[51] Dominion LDCs and New England LDCs and PGC believe that Tennessee should provide this option. Dominion LDCs state that Tennessee should be required to notify shippers of Critical Days by telephone or fax, as well as on PASSKEY and e-mail. Further, the Dominion LDCs believe that the Critical Day notice period should be expanded from 11 hours to 24 hours. PGC argues that the Commission misinterpreted its request that Tennessee be required to post Critical Day information by telephone or fax, as well as on PASSKEY and e-mail. PGC argues that the new notification system is a hardship, and is inadequate to satisfy Order No. 637's requirement to post information necessary to minimize the adverse impacts of these measures.

84. Dominion LDCs also request rehearing of the Commission's order finding that gave Tennessee the option to limit under an OFO firm services to the uniform hourly provision requirement under the terms of the rate schedule. Dominion LDCs claim that this is not a requirement under the terms of certain rate schedules, and such a limitation would alter drastically the level of service customers pay for. Dominion LDCs and KeySpan cite Rate Schedule FT-A, § 4.11, which provides Tennessee must allow a shipper to deliver or receive gas at greater than uniform hourly flow subject to Tennessee's operating conditions. Dominion LDCs contend that Tennessee has other tariff provisions, as pointed out in the April 3 Order, which should be used before

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[50] Citing Southern Natural Gas Pipeline Company, 80 FERC ¶ 61,233 at 61,890 (1997) and Williams Gas Pipeline Central, Inc. (Williams), 90 FERC ¶ 61,262 (2000).

[51] Citing Standards for Business Practices of Interstate Natural Gas Pipelines, Order on Rehearing and Clarification, 95 FERC ¶ 61,423 (2001).

degrading firm service. KeySpan, in both its request for rehearing and comments on Tennessee's compliance filing, asks the Commission to clarify that the April 3 Order did not intend to afford Tennessee any greater rights to require uniform hourly quantities than what was reflected in Rate Schedule FT-A, § 4.11, or, adds New England LDCs, any of the other services noted in the April 3 Order.

c. Commission Response

85. Dynegy and Clarksville state that a decrease in operational storage cannot be considered a situation of urgency. The argument misstates the issue. As stated in the April 3 Order, OFOs are not invoked only when a pipeline is in operational distress. OFOs involve an element of prediction. An OFO may be called when action is necessary to avoid a situation in which the system integrity is jeopardized or the pipeline's ability to render firm service is threatened.[52] In Order No. 637-A the Commission explained that the requirement that penalties may be imposed only to the extent necessary may result in either no penalties for non-critical days or higher tolerances and lower penalties for non-critical days as opposed to critical days.[53] A decrease in operational storage may cause a situation where system integrity or the pipeline's ability to render firm service is threatened. This provision is also coupled with an OFO provision requiring a threat to system integrity or firm service. Proposed Article VIII, Section 2 of Tennessee's GT&C provides that OFOs will be issued to alleviate conditions which threaten or could threaten the integrity of Tennessee's system or Tennessee's ability to maintain operations to provide efficient and reliable firm service.[54]

86. We also find that the condition "to forestall the deterioration of operational conditions on its system" is not unreasonably vague for calling Critical Days, since

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[52]Tennessee, 99 FERC ¶ 61,017 at P 230 (2002). The Southern Natural Gas Pipeline Company order cited by Dynegy (80 FERC ¶ 61,233 at 61,890 (1997)) does not address this issue on the merits. The order set the issue of Southern's OFO penalty structure and use of its OFOs for technical conference. Protesters were concerned about the level of OFO penalties and the fact that Southern frequently used OFOs on its system.

[53]Order No. 637-A at 31,609.

[54]The Williams order cited by Dynegy is not on point. Williams proposed OFO provision established a standard based on the shipper's storage balance, not the pipelines operational storage. The Commission was concerned that Williams did not considered its ability to provide storage service. In this case Tennessee's provision pertains to operational storage which impacts Tennessee's ability to operate its system.

Article VIII, Section 4.1 goes on to enumerate specific conditions which cause deterioration of operational conditions. In addition, on a system as large as Tennessee's, there are practical problems in quantifying all potential possible scenarios of storage and line pack that might require preventive actions for the good of the system as a whole. If parties believe that a pipeline is misusing its OFO discretion to either withhold capacity or discriminate among customers, parties may file a complaint with the Commission.

87. There is no need to require Tennessee to provide additional back-up means of communication to the internet notification. In the compliance filing accepted in this order, as modified below, proposed Article VIII, Section 4.3 of the GT&C provides that Tennessee shall notify the customer of the issuance of a critical day via telephone in addition to internet notification. Notification of Action Alerts and Balancing Alerts are in accordance with Article VIII, Section 2.3 which also provides that Tennessee shall notify recipients of an OFO via telephone in addition to internet notification. Neither Order No. 637 nor Section 284.12(c)(3) of the Commission's regulations requires more notification.[55]

88. The Commission affirms its acceptance of the 11-hour notice for Critical Days. Tennessee may face detrimental behavior that requires more immediate action to maintain operational integrity than permitted by a 24-hour notice period. Further, 11 hours prior to the gas day notification provides multiple opportunities for shippers to adjust supply nominations. Not only does Tennessee offer the NAESB required Intraday 1 and 2 nominations effective the same gas day, it also offers hourly nominations to be effective the next hour between the hours of 10:00 p.m. and 8:00 a.m., or as otherwise agreed to by Tennessee. There is no general rule for determining the amount of time needed to notify shippers of imposition of an OFO, as each pipeline has different operating characteristics during a pipeline emergency which requires control of gas flow.[56] Tennessee's proposal provides for Tennessee to share information with shippers of potential problems and retains the Action Alert OFO with 48 hours notice to give shippers more advanced notice where circumstances permit. Tennessee's proposed OFO provisions provide sufficient notice of potential Critical Days to comply with Order No. 637.

89. The Commission clarifies that it did not intend to afford Tennessee any greater rights to require uniform hourly quantities than what is reflected in the rate schedule under which service is provided. If the terms of a particular rate schedule do not require uniform hourly flows, Tennessee may not impose such a limitation because such action

[55] 18 C.F.R § 248.12(c)(3) (2003).

[56] Egan Hub Partners, L.P., 99 FERC ¶ 61,378 at P 12 (2002).

would degrade firm service. The April 3 Order recognized that the uniform hourly flow requirement did not apply to all of Tennessee's rate schedules. In the compliance filing discussed below, the Commission addresses Tennessee's proposed compliance with the April 3 Order on these issues.

7. OFO Penalties

a. April 3 Order

90. Tennessee's current tariff has an Action Alert penalty which is twice the currently effective daily variance penalty for gas volumes deviating from the Action Alert tolerance level and a Balancing Alert penalty of $15/Dth plus the applicable daily regional spot price for gas volumes deviating from the OFO requirements. The April 3 Order required Tennessee to change the basis of the calculation of the Action Alert penalty from the daily scheduling variance penalty, since the daily variance penalty will be replaced by the proposed Daily Imbalance Charge. The April 3 order accepted Tennessee's proposed additional intermediate OFO penalty tiers designated as Critical Day One and Critical Day Two. However, the April 3 Order rejected Tennessee's proposal to increase the Balancing Alert penalty. Tennessee's current OFO penalties and proposed compliance filing OFO penalties are as follows:

Effective and Proposed OFOs and Related Penalties

OFO level	Effective		Proposed Compliance	
	Notice	Penalty per dth	Notice	Penalty per dth
Daily Variance[57]	LMS-PA 48 hrs LMS-MA 8 hrs	\$0.1099 \$0.3936		
Daily Imbalance[58]			Upon reaching 5% system imbalance	>10% and <=20% 2 x RS. PAL >20% 4 x RS. PAL
Action Alert	48 hrs	2 x RS. LMS Daily Variance	48 hrs	>10% and <=20% 2 x RS. PAL >20% 4 x RS. PAL
Critical Day 1			11 hrs	\$5 plus highest regional daily spot gas price
Critical Day 2			Critical Day 1 plus effective 9 a.m. CCT next gas day	\$10 plus highest regional daily spot gas price
Balancing Alerts	8 hrs	\$15 plus highest regional daily spot gas price	8 hrs	\$15 plus highest regional daily spot gas price

[57]Tennessee does not place the Daily Variance Penalty in its OFO section of its tariff. The Commission classifies this penalty as an OFO penalty as it is activated when system operating conditions could result in impairment of reliable firm service. 99 FERC ¶ 61,017 at P 220 (2002).

[58]Tennessee does not place the Daily Imbalance Penalty in its OFO section of its tariff. The Commission classifies this penalty as an OFO as it is activated when system operating conditions could result in impairment of reliable firm service. 99 FERC ¶ 61,017 at P 220, fn 84 (2002).

b. Request for Rehearing

91. The Indicated Shippers argue that the OFO penalties and the Daily Imbalance Charge will increase Tennessee's reliance on penalties, individually and collectively, by tightening penalty tolerances and increasing the penalty amounts. They assert that Commission approval of these penalties will transfer the cost of system management to balancing parties. The result, the Indicated Shippers believe, is an oppressive penalty system contrary to the objectives of Order No. 637 to shift the focus away from penalties and toward positive incentives. Further, the Indicated Shippers continue, Tennessee failed to support the need for the new penalties. Similarly, PGC argues that the proposed graduated OFO penalty structure is unjustified and unreasonable. PGC contends that Order No. 637 requires a two stepped analysis: (1) a determination that the graduated penalty structure will reduce the incidences of OFOs on Tennessee's system; and (2) a determination that the individual penalties are operationally justified. The Indicated Shippers and PGC assert that Tennessee has not supported any of these penalties.

c. Commission Response

92. The Commission generally affirms the April 3 Order's acceptance of Tennessee's proposed OFO penalties. However, as discussed in the compliance section of this order below, the Commission will require Tennessee to revise the Action Alert penalty proposed in its compliance filing to a level no greater than what is currently in effect.

93. Contrary to the Indicated Shippers contention, the April 3 Order did not tighten the OFO penalty tolerances or increase the OFO penalties. The April 3 Order made no changes to the Action Alert and Balancing Alert tolerances. The April 3 Order also did not change the Balancing Alert's penalty. With regard to the Action Alert penalty, the April 3 Order noted that the daily variance charge basis for the penalty would disappear, therefore Tennessee had to update the penalty to reflect that fact. The Daily Imbalance Charge, Critical Day One and Two are new intermediate OFO levels with new penalties less than the existing Balancing Alert OFO and related penalty. The Commission finds that increased OFO levels gives pipelines a greater range of tools to keep OFOs closely proportioned with the operational problem. Adding additional OFO levels is beneficial to Tennessee's customers as they will not go immediately from the Action Alert penalty to the much more stringent Balancing Alert penalty.

94. The Indicated Shippers and PGC argue that the OFO levels and penalties are not required and have not been supported. Article VIII, Section 2 of Tennessee's GT&C provides that OFOs will be issued to alleviate conditions which threaten or could threaten the safe operation or system integrity or Tennessee's system or to maintain operations

required to provide efficient and reliable firm service. Therefore, OFOs are based on the operational needs of the pipeline. Introducing additional levels below the strictest OFO level, which is what Tennessee proposes, reduces the probability that the strictest OFO would be issued. A pipeline is not required to experience operational impairments before designing an OFO. Tennessee's Critical Day and Daily Imbalance OFOs are clear statements on its part that it can identify operational situations that may impair service that do not require the full power of a Balancing Alert OFO and related $15 per dth penalty. OFO penalties are appropriate to encourage proper shipper behavior when these adverse operational conditions exist. OFO penalties are not expected to be incurred.

8. Penalty Revenue Crediting

a. April 3 Order

95. The April 3 Order found that all shippers, including interruptible shippers and short term shippers, are subject to penalties. Therefore, the Commission required Tennessee to credit net penalty revenues to both firm and interruptible shippers.

b. Requests for Rehearing

96. Tennessee asserts that the Commission failed to justify its finding that Tennessee may not limit penalty crediting to long-term firm shippers. Tennessee argues that the long-term firm shippers ensure the stability of the pipeline revenues, significantly contributing to lower interest costs and thus lower rates for all shippers. Tennessee states that the Commission has not distinguished its proposal from the proposal accepted in Dominion Transmission, Inc.[59]

97. Clarksville claims that the Commission ignored its request that Tennessee support its request to use certain costs to offset penalty revenues to be credited to shippers. Further, Clarksville requests rehearing of the requirement that Tennessee credit both firm and interruptible shippers. Clarksville claims that no party proposed this requirement, and that the Commission's policies, established in case law, were wrongly decided and inconsistent with other Commission precedents.[60] Clarksville claims that the theory a customer may incur a penalty is not sufficient qualification for that customer to receive credits. Under § 284.12(c)(2)(v) of the Commission's regulations, penalties are supposed

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[59] Dominion Transmission, Inc., 95 FERC ¶ 61, 316 at 62,086 (2001). See also, National Fuel Gas Supply Corp., 96 FERC ¶ 61,182 (2001).

[60] Paiute Pipeline Company, 96 FERC ¶ 61,167 (2001) (Paiute)

to be imposed only to the extent necessary to prevent impairment of reliable service. Therefore, Clarksville and the Dominion LDCs continue, penalties will be imposed only during peak critical periods. They state the only services threatened during such times are firm services, as interruptible services will have been interrupted before the time penalties would be imposed. Therefore, the probability interruptible customers will be assessed a penalty is very low, and the presumption that they are due a penalty revenue credit is flawed. Accordingly, they contend only non-offending firm shippers should receive penalty revenue credits.

98. New England LDCs argue that if a service is not subject to penalties, customers under that service should not receive penalty revenue credits. New England LDCs suggest using the penalty revenue crediting mechanism approved in Trailblazer[61] as a means of achieving this objective. In Trailblazer, the Commission approved allocating penalty revenues on the basis of non-offending shippers' revenue contribution.

99. The Indicated Shippers argue that the Commission was in error when it failed to require crediting of OFO penalties (other than Daily Imbalance Charges) to non-penalized balancing parties under Rate Schedules LMS-MA and LMS-PA (Balancing Parties). The Indicated Shippers believe that the April 3 Order was in error presuming that balancing parties were not subject to OFO penalties. As they are subject to penalties, the Indicated Shippers believe balancing parties should be eligible for net OFO penalty revenue credits
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c. Commission Response

100. The Indicated Shippers question whether Balancing Parties (also referred to as point operators) were to be included as recipients of penalty revenue credits. The Commission finds that Tennessee's proposal must be revised to include Balancing Parties, because they are subject to penalties under Tennessee's tariff.

101. At points with OBAs, Balancing Parties may be assessed imbalance and OFO penalties on a point imbalance basis. Point data are net values reflecting all shippers behind the point, not the individual performance of one transportation shipper. For example, a single transportation shipper behind an OBA point may have an extreme imbalance. But if the other transportation shippers' performances ameliorate the imbalance to bring the total point's imbalance to within no-penalty tolerance, Tennessee does not assess a penalty to the OBA operator. Point operators also can net multiple points and trade point imbalances. Therefore, there appears little basis for Tennessee to

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[61] Trailblazer Pipeline Company, 97 FERC ¶ 61,056 at 61,307 (2001) (Trailblazer).

attribute penalty revenues to shippers behind Balancing Parties or to determine who are non-offending shippers behind Balancing Parties eligible for penalty credits.[62]

102. The Commission considered a similar issue in its December 19, 2002 order in Docket No. RP02-114-001, rejecting Tennessee's proposal (similar to the proposal in this proceeding) to provide refunds from cashout and imbalance penalties to long-term firm customers, and requiring that the refunds be credited to the OBA point operators, because they were the ones responsible for paying the cashouts and penalties.[63] The Commission further found that only the OBA operators would be able to determine who is a non-offending shipper behind its point and that, therefore, any credits to shippers behind the point would be governed by their agreement with the point operator.

103. We, therefore, find that Tennessee must revise its tariff, consistent with the determination in Docket No. RP02-114 to provide for the payment of penalty credits to Balancing Parties. Since rehearing of the December 19, 2002 order is pending, to the extent that any changes are made with respect to crediting, Tennessee must file to make any conforming changes to its proposal in this proceeding. In addition, to the extent that there are shippers at points not governed by OBAs, or shippers behind OBAs are individually subject to paying penalties, Tennessee must include a mechanism for including such shippers subject to penalties in any penalty credit.

104. To the extent that shippers are included in penalty crediting, the Commission denies rehearing of its finding that Tennessee may not limit penalty revenue crediting to long-term shippers. Commission policy requires that long-term firm, short-term firm, and interruptible shippers share in the revenue crediting mechanism, since they are subject to the penalties that generate the revenue to be credited.[64] Moreover, this policy provided all shippers, including interruptible shippers, an incentive to adhere to the tariff provisions. While there may be some language in Order No. 637-A that appears to indicate that the penalty revenues are to be credited only to firm shippers, that language was said in response to pipelines' contention that they should keep the revenue.[65] The Commission's regulations in Section 284.12(c)(2)(v) provide that pipelines "must credit

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[62]Tennessee proposed in its filing that credits not be paid to shippers that incurred a penalty during the month.

[63]Tennessee, 101 FERC ¶ 61,303 (2002).

[64]Equitrans, L. P., 101 FERC ¶ 61,018 (2002).

[65]See Texas Eastern Transmission, LP, 102 FERC ¶ 61,198 at P 127 (2003).

[penalty revenue] to shippers," and is not limited to firm shippers. Thus, the Commission has consistently held that all shippers are to share in the crediting of penalty revenue.[66] The Commission recently confirmed this policy.[67] Furthermore, interruptible shippers increase the throughput on the system and contribute to the efficient use of the system by using capacity that might otherwise go un-subscribed. Interruptible shippers also add revenues toward recovering pipeline costs. The fact that no party proposed crediting penalty revenue to interruptible shippers does not change Tennessee's obligation to comply with Section 284.12(c)(2)(v) of the Commission's regulations and Commission policy. The argument that penalties will be imposed only during peak critical periods does not withstand scrutiny. OFOs are not a function of utilization of pipeline capacity near peak level, but of system reliability. For example, Tennessee proposes Daily Imbalance Charges. This charge applies when the system is critically out of balance, not when the system is near peak utilization.

105. The Commission rejects Clarksville's requirement that Tennessee justify any cost offset to penalty revenues by making a filing in this proceeding. The appropriate forum for addressing this issue is in the filing in which Tennessee actually files to credit penalty revenues net of costs.[68] At that time Tennessee will have the burden to justify any costs used to offset the credits. The April 3 Order explained the type of costs that may be used as an offset (the cost of gas and related expenses from the penalty revenues). This is

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[66] See Columbia Gas Transmission Co., 100 FERC ¶ 61,344 at P 127 (2002); East Tennessee Natural Gas Company, 98 FERC ¶ 61,060 at P 126 (2002); and Questar Pipeline Company, 98 FERC ¶ 61,159 at 61,584 (2002). The Dominion Transmission, Inc., order cited by Tennessee, is a black box settlement and it was not apparent from the settlement filing that crediting was limited to firm shipper. Therefore, it is not an appropriate precedent. The National Fuel Gas Supply Corp., order cited by Tennessee is not a persuasive precedent, since the order did not directly address the issue.

[67] Texas Eastern Transmission, LP, 102 FERC ¶ 61,198 at P 127 (2003). In Panhandle Eastern Pipe Line Company's (Panhandle) Order No. 637 proceeding, while recognizing that the Commission's regulation contemplates crediting penalty revenues to all shippers, the Commission accepted Panhandle's proposal to credit penalty revenues to firm shippers since is was part of a comprehensive settlement to resolve all the issues related to Panhandle's compliance with Order No. 637 and the provision was not protested. In this case, Tennessee's proposal is not part of a comprehensive settlement.

[68] See e.g. Colorado Interstate Gas Company, 95 FERC ¶ 61,321 at 62,125 (2001).

consistent with the Paiute order cited by Clarksville.[69] In that case the concern was the crediting of revenues against unspecified costs. The order stated that Paiute may offset revenue credits with all reasonablely related costs.[70]

106. The Commission denies the New England LDCs' request that Tennessee be required to use the crediting mechanism used in Trailblazer. The fact that the Commission approved such a mechanism in Trailblazer does not mean that mechanism is appropriate for Tennessee; nor does Order No. 637 require a specific penalty revenue sharing mechanism. As discussed above, Tennessee's penalty revenue crediting mechanism has to accommodate its balancing penalty system. Therefore, it is not appropriate to impose the Trailblazer mechanism on Tennessee.

B. Compliance Filings: Docket Nos. RP00-477-003, RP01-18-003 and RP98-99-008; and Docket No. RP03-183-000

1. Scheduling Equality

a. April 3 Order

107. Section 284.12(c)(1)(ii) of the Commission's regulations requires pipelines to "permit shippers acquiring released capacity to submit a nomination at the earliest available nomination opportunity after the acquisition of capacity."[71] In Order No. 637, the Commission explained that this rule will enable shippers to acquire capacity at any of the nomination or intra-day nomination times, and nominate gas coincident with their acquisition of capacity.

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[69] Paiute Pipeline Company, 96 FERC ¶ 61,167 at 61,755 (2001).

[70] With respect to the Daily Imbalance Charge, in the compliance filing addressed below Tennessee has revised its tariff to delete the language "net of costs" from the crediting provisions related to its Daily Imbalance Charge as directed by the April 3 Order. Therefore, Tennessee will absorb all the costs involved in the Daily Imbalance Charge until its next rate case.

[71] 18 C.F.R. § 284.12(c)(1)(ii) (2003).

108. The April 3 Order required Tennessee to modify its tariff in a manner consistent with capacity release timelines found in Version 1.5 of NAESB[72] Standard 5.3.2, to comply with § 284.12(b)(1)(ii)'s requirement that pipelines "permit shippers acquiring released capacity to submit a nomination at the earliest available nomination opportunity after the acquisition of capacity."

b. Tennessee's Compliance and Commission Ruling

109. Tennessee filed tariff sheets that incorporated Version 1.5 of NAESB Standard 5.3.2. However, in Docket No. RP02-436-000, Tennessee also complied with Order No. 587-O, and proposed tariff sheets that implemented Version 1.5 of NAESB standard 5.3.2. The Commission accepted Tennessee's compliance with that standard, effective October 1, 2002.[73] Therefore Tennessee's proposed tariff sheets in the instant proceeding implementing this standard are rejected as moot.

2. Segmentation

a. April 3 Order

110. Order No. 637 requires pipelines to permit a shipper to use its contracted firm capacity by segmenting that capacity into separate parts for its own use or for releasing segmented capacity to replacement shippers to the extent such segmentation is operationally feasible.[74]

111. The Commission found that Tennessee's existing segmentation generally complied with Order No. 637, with the possible exception of grandfathered contracts. The Commission stated that it is not clear from Tennessee's filing or the protests of the New England LDCs exactly how capacity release and segmentation operate under Tennessee's tariff with respect to shippers with redundant delivery point rights. Therefore, the April 3 Order required Tennessee to explain how shippers with redundant delivery point rights can avail themselves of capacity release and segmentation. Tennessee was required to explain whether in a release of capacity by a shipper with grandfathered delivery points, the replacement shipper receives primary delivery point rights to specified delivery

[72] North American Energy Standards Board, formerly the Gas Industry Standards Board.

[73] Tennessee Gas Pipeline Co., 100 FERC ¶ 61,340 (2002).

[74] 18 C.F.R. § 284.7(d) (2003).

points, and what release rights remain for the redundant rights held by the releasing shipper. It also was required to explain how the replacement shipper's rights affect the ability of the releasing shipper to use capacity at its redundant points. Tennessee was required to explain how a shipper with redundant points can segment capacity both in areas outside of its delivery point area and within the delivery point area. Tennessee was also required to demonstrate that these explanations of segmentation and release rights are consistent with the Commission's requirements at § 284.8(b) of the regulations.

b. Tennessee's Explanation

112. Tennessee states that the April 3 Order's requirement to review the segmentation rights of grandfathered open access transportation agreements went beyond the scope of Tennessee's compliance filing. Nonetheless, Tennessee states that it provides grandfathered contracts the same release rights as point-to-point Rate Schedule FT-A shippers.

113. Tennessee explains that the grandfathered services came about as the result of a settlement in the Order No. 636 restructuring proceeding. Under the terms of the settlement and the implementing tariff, certain pre-restructuring shippers received the right to contract for delivery of gas to a group of delivery points. Each of the delivery points have contract maximum delivery capabilities which, in total, exceed the contract maximum receipt quantities. Shippers may nominate up to the receipt levels, but not the sum of the delivery levels. The delivery capacity not nominated or scheduled is referred to as redundant capacity. Tennessee's explanation is summarized in Table 1 below.

Table 1: Grandfathered Contract Rights

Points	Contract Dth (a)	Example Nomination/ Scheduled Dth (b)	Redundant Capacity Dth (c)
Receipt	10,000	10,000	NA
Delivery A	10,000	3,000	7,000
Delivery B	7,500	2,000	5,500
Delivery C	5,000	5,000	0
Total Delivery	22,500	10,000	12,500

114. The same settlement and implementing tariff, however, limited the grandfathered shippers release rights to the equivalent of a normal point-to-point Rate Schedule FT-A service. This means, Tennessee explains, that total receipts and total deliveries must not exceed the original grandfathered contract's quantity. Table 2 below shows an example of a release.

Table 2: Release of a Grandfathered Contract
Tennessee's Position

Points	Grandfathered Contract Dth (a)	Grandfathered Retained Contract Dth (b)	Grandfathered Retained Redundant Capacity Dth (c)	Point-to-Point Released Dth (d)
Receipt	10,000	5,000	NA	5,000
Delivery A	10,000	5,000		5,000
Delivery B	7,500	7,500		0
Delivery C	5,000	5,000		0
Total Delivery	22,500	17,500	12,500	5,000

115. Tennessee explains that grandfathered shippers retain the same level of redundant capacity as existed prior to the release. This results from the fact that Rate Schedule FT-A is a point-to-point service, and, therefore, all redundant capacity rights stay with the grandfathered service. Even if a grandfather shipper where to release all of its capacity, the redundant capacity cannot be transferred to the replacement shipper.

116. Tennessee states that it has automated the grandfathered service release process. Those who wish to release capacity must, in essence, convert their released grandfathered capacity into a Rate Schedule FT-A contract through the electronic self-segmentation procedures on its web-site. Once the self-segmentation process is completed, the capacity may be resegmented and/or released. Replacement shippers have the same right as any other Rate Schedule FT-A replacement shipper to resegment and/or release acquired capacity.

117. Tennessee believes that the New England LDCs are attempting to expand their segmentation and capacity release rights beyond what the settlement and tariff provide. Tennessee provides an example of what it believes the New England LDCs are requesting. The Commission developed Figure 1, from Tennessee's example. Tennessee starts from the base example described above, and assumes a release of the full 10,000 Dth contract which is segmented at Delivery A. Under this example, a full 10,000 Dth is scheduled to Delivery A utilizing a segmented Release 1. Under the grandfathered contract, no further deliveries to Delivery Points B or C could be performed, as all available delivery capacity would have been utilized at Delivery Point A. However, Tennessee believes that the New England LDCs wish to be able to continue moving the full 10,000 Dth utilizing the segmented Release 2 from Delivery Point A to either Delivery Points B and C. This results, in Tennessee's opinion, in total deliveries of 20,000 Dth (10,000 Dth at Delivery Point A plus 10,000 Dth at Delivery Points B and C), which is a circumvention of the grandfathered contracts' limitation of delivering only a maximum 10,000 Dth. Variations on this example, Tennessee states, could result in the full 22,500 Dth of delivery point capacity becoming locked up. This would result in more flexibility than a non-grandfathered Rate Schedule FT-A shipper can

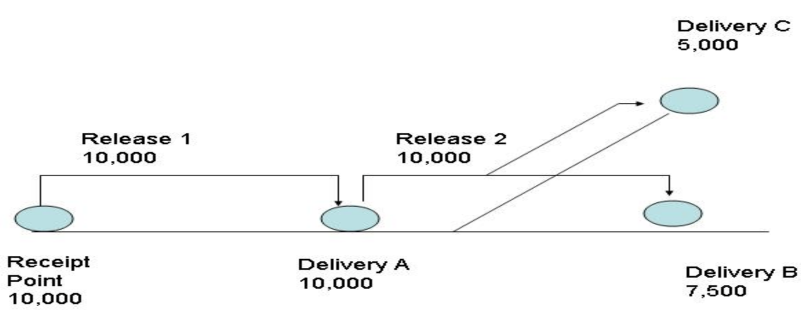

Figure 1

achieve, and would result in a degradation of firm service of others as firm delivery capacity is locked up.

118. Tennessee states that its current practices with regard to the redundant capacity grandfathered contracts, capacity release and segmentation are just, reasonable and consistent with Commission regulations. Tennessee is not imposing any restrictions on redundant capacity segmentation or release, and is merely enforcing the terms of the settlement and tariff that deliveries equal receipts, and deliveries at contract delivery points cannot exceed the grandfathered contracts' figures.

c. Protests and Comments

119. KeySpan argues that shippers with redundant right contracts should have the right to release their contracts in full or in part, segmented or non-segmented. Section 284.8(b), KeySpan and New England LDCs state, establishes this requirement. KeySpan also notes that, notwithstanding Tennessee's claim that the grandfathered contracts were the result of the Order No. 636 restructuring, the Commission has consistently broadened capacity release and segmentation rights for all open access firm services. Requiring Tennessee to do the same with the grandfathered contracts would be consistent with these decisions. New England LDCs argues that another reading of the settlement is that it did not address the issue of capacity release.

120. New England LDCs believes that Tennessee misunderstood its position. New England LDCs state that it agrees with Tennessee that the total deliveries by releasing and replacement shippers may not exceed the releasing shipper's maximum daily quantities. Rather, New England LDCs believe that replacement shippers should have the same right to delivery point flexibility as available to the releasing shipper. Just as the releasing shipper may shift deliveries among multiple delivery points, replacement shippers to these contracts should have the same rights.

121. ConEd notes that much of what Tennessee explains with regard to the grandfathered contracts is not in its tariff. ConEd believes that there is a need for tariff language that adequately explains these rights. Further, ConEd submits that Tennessee's practices have been inconsistent and unreasonable, and that customers are entitled to rely on the tariff as opposed to unwritten policies. For example, ConEd claims that, in comparison to point-to-point restriction described by Tennessee in Table 1, Tennessee inflicted upon it a reduction of redundant delivery point rights in proportion to the released quantities. Tennessee responds that the situation ConEd refers was not a capacity release situation, but an issue of contract termination and reassignment due to a ConEd internal reorganization. ConEd also objects to Tennessee's proposal to address the

need to modify the grandfathered contracts to effect state unbundling on a waiver of the tariff basis. ConEd prefers to have the parameters in the tariff.

d. Commission Ruling

122. Tennessee's arguments with respect to the issue of primary points for the grandfathered contracts (in which delivery point contract demand is greater than the mainline contract demand) appear predicated on its position (rejected earlier) that it should not have to comply with the Texas Eastern/El Paso policy by providing replacement shippers with the ability to obtain primary points in excess of the original primary points in the releasing shipper's contract. Since Tennessee is required to comply with the Texas Eastern/El Paso policy, the Commission will clarify the application of its policies to the grandfathered contracts.

123. Grandfathered contacts should be treated essentially the same as firm contracts without the redundant delivery point rights. There are two separate issues that need to be addressed: the determination of primary point rights as a result of the release; and the ability of the replacement shipper on a segmented, secondary release to obtain primary points under the Texas Eastern/El Paso policy.

124. First, to the extent that the replacement shipper obtains primary point rights as a result of the release, Tennessee can require an equivalent reduction in the releasing shipper's total allocation of primary point rights. In addition, the releasing shipper can designate how its primary point rights will be reduced. For example, under the previous examples, if the releasing shipper releases 5,000 Dth of capacity (retaining 5,000 Dth) from the receipt point to the market area, the releasing shipper's primary delivery point rights in the market area would need to be reduced by 5,000 Dth. But the releasing shipper and replacement shipper can choose at which points such a reduction will occur. For example, the releasing shipper could choose to reduce its primary delivery point capacity at point A by 5,000 Dth or could reduce its delivery point capacity at point A by 2,500 Dth and its delivery point capacity at point C by 2,500 Dth.

125. Tennessee and New England LDCs do not appear to disagree that the overall delivery point rights of the releasing and replacement shipper cannot exceed the previous total of primary point rights. New England, however, states that Tennessee should allow the releasing shipper to "give the replacement shipper the same right to delivery point flexibility as is contractually available to the releasing shipper." Protest, at 6. It is not clear exactly what rights New England is requesting. If New England is requesting that the releasing shipper be allowed to release primary point rights that exceed the

replacement shipper's contract demand,[75] the Commission agrees with Tennessee that it does not have to permit the replacement shipper to obtain redundant primary delivery point rights (primary delivery point rights in excess of its contract demand). The replacement shipper should be treated as any other FT shipper, whose primary delivery point rights cannot exceed its contract demand. In effect, the grandfathered redundant primary delivery point rights are unique to the grandfathered shipper and are not transferable to a replacement shipper obtaining standard FT service.

126. Second, if there is a segmented release on a secondary basis, the replacement shipper will obtain no primary point rights as a result of the release, but still retains the right to request primary points under the Texas Eastern/El Paso policy. For example, the releasing shipper in the example, can retain 10,000 Dth of primary point capacity from the receipt point to delivery point A, and using a segmented release, release 10,000 Dth of capacity from delivery point A to delivery point B on a secondary basis (no primary points obtained as a result of the release). However, once having obtained the secondary point capacity, the replacement shipper can request, and obtain, primary points equal to its 10,000 Dth contract demand, but only to the extent that such points are available on a primary basis.

3. Overlapping Nominations

a. April 3 Order

127. The goal of segmentation is to give firm shippers the flexibility to use their own capacity and to enhance competition between shippers and between shippers and the pipeline. The Commission made it clear that failure to allow segmentation would only be permitted when such segmentation is not operationally feasible.

128. Order No. 637-A stated that a forward-haul and back-haul to a single point did not result in a capacity overlap even though the total amount received by the shipper exceeded contract demand.[76] This right will permit firm shippers the flexibility to use

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[75] For example, on a release of 5,000 Dth/day of mainline capacity, New England may be requesting that the releasing shipper be able to provide the replacement shipper with primary point rights in excess of 5,000 Dth/day, as long as there is an equal reduction in the releasing shipper's primary point rights.

[76] Order No. 637-A at 31,593, citing Transcontinental Gas Pipe Line Corporation, 91 FERC ¶ 61,031 (2000). See also Kinder Morgan Interstate Gas Transmission LLC, 97

(continued...)

their own capacity and to enhance competition between shippers and between shippers and Tennessee. The April 3 Order and, subsequently, the *Order on Remand*, required Tennessee to clarify its tariff to permit this result.

b. Tennessee's Compliance

129. Tennessee, in Docket No. RP03-183-000 on December 2, 2002, filed tariff sheets in compliance with the *Order on Remand*. Tennessee proposes to add a provision to Article III, Section 4 of its GT&C to allow a shipper to segment by nomination in a manner consistent with the *Order on Remand*. Tennessee also proposes at Article III, Section 11.11(n) to clarify that while releases involving overlapping segments in excess of contract entitlements are generally not permitted without charge, Tennessee will allow them in the limited circumstances of forwardhaul and backhaul to the same point at the same time. Tennessee also states that it has filed for rehearing of the *Order on Remand*, and reserves the right to modify this proposal as the result of further Commission or Court orders.

130. Docket No. RP03-183-000 was noticed on December 6, 2002, with motions to intervene and protests due December 13, 2002. Appendix B lists the motions to intervene, parties filing comments and protests, and parties who filed late motions to intervene. Pursuant to Rule 214 (18 C.F.R. § 385.214), any timely filed motion to intervene is granted unless an answer in opposition is filed within 15 days of the date such motion is filed. Timely filed motions to intervene not listed in Appendix B are also granted in accordance with the conditions of Rule 214. No answer in opposition to late motions to intervene was filed. Pursuant to 18 C.F.R. § 385.214(d), the Commission finds that granting late intervention at this stage of the proceeding will not disrupt this proceeding or place additional burdens on existing parties. Consequently, the motions for late intervention filed before the issuance of this order are granted. Tennessee filed an answer to the comments and protests.[77] The Commission addresses the parties comments and protests below.

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[76](...continued)
FERC ¶ 61,062 at 61,336 (2001).

[77]While the Commission's Rules of Practice and Procedure generally prohibit answers to protests, the Commission will accept the answer to allow a better understanding of the issues. See 18 C.F.R. § 385.213(a)(2) (2003).

c. Discussion and Commission Ruling

131. The Commission rejects certain sheets and tariff language in the December 2, 2002 compliance filing, and conditionally accepts Tennessee's proposed tariff sheets shown on Appendix A, effective September 1, 2003.

132. New England LDCs protest that Tennessee, in its compliance filing, still proposes to prohibit backhaul segmentation on laterals. The Commission addressed this issue above in the Overlapping Point Nominations section in the rehearing portion of this order, and rejected the New England LDCs rehearing request. The *Order on Remand* did not expand the Commission's findings on backhauls to a point on laterals. The Commission rejects the New England LDCs' protest.

133. Rhode Island Trust protests proposed Article III, Section 4(j) of Tennessee's GT&C. It argues that Tennessee went beyond the requirements of the *Order on Remand* and proposed language that would limit shippers ability to define segments that include points on laterals. Rhode Island Trust argues that shippers should have the ability to segment within its reserved path. Tennessee, in its answer, argues that its proposed language tracks existing language at Article III, Section 11.11(n) of its GT&C, and was approved as part of its proceeding in Docket No. RP02-17, et al. (Stagecoach order).[78]

134. Proposed Article III, Section 4(j) states in part:

> A Shipper under rate schedule FT-A, FT-G or NET 284 may nominate segments between a Primary Receipt and Delivery Point or between any two points in Shipper's Transportation path, provided that for Shippers with Primary Receipt and Primary Delivery Points solely on an Incremental Lateral as defined in Article XVIII, Section 2 of the General Terms and Conditions, such Shippers may nominate a segment only on the Incremental Lateral and Shippers without Primary Receipt and Primary Delivery Points on the Incremental Lateral shall not nominate any segment containing points on the Incremental Lateral....

135. The Commission requires Tennessee to delete or modify this language. First, the provision only permits shippers to nominate segments between "a Primary Receipt and

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[78] Citing Tennessee Gas Pipeline Co., 97 FERC ¶ 61,133 (2001) (Stagecoach).

Delivery Point or between any two points in Shipper's Transportation path." Such a provision conflicts with a shipper's right to use flexible point rights outside the path, but within the zone for which the shipper pays.[79]

136. Second, although Tennessee contends the provision with respect to laterals is consistent with the Commission's order in Stagecoach, the provision appears inconsistent with the Stagecoach order. The Stagecoach order required Tennessee to explain how its extended receipt and delivery point provisions would apply to the incrementally priced Stagecoach lateral. 97 FERC ¶ 61,133 (2001). In a subsequent compliance filing, Tennessee proposed, and the Commission accepted, a tariff provision that would permit FT-A shippers to have extended transportation service on the Stagecoach lateral by paying the authorized overrun charge. 97 FERC ¶ 61,267 (2001). However, the proposed tariff sheet could be read as precluding shippers from using their extended transportation service to access points on a lateral.

137. PSEG also protests Tennessee's proposal at Article III, Sections 4(j) and 11.11(n) to treat the backhaul segment as out of the path during times when location restrictions may be in effect. PSEG argues that the *Order on Remand* did not address this issue, and the proposed tariff language would unjustifiably encumber full use of segmentation rights. Nashville and the Indicated Shippers, addressing the same proposed language, are concerned that Tennessee may be placing simultaneous forwardhaul and backhaul nominations in a lower priority to primary and secondary transactions that are within the path. PSEG, the Indicated Shippers and Nashville request that the Commission reject the proposed location restriction.

138. Tennessee responds that PSEG, the Indicated Shippers and Nashville have misunderstood the proposed tariff language. Tennessee explains that a backhaul contract's forward haul nomination would be out of the path, whereas a backhaul would be within the path.

139. Tennessee's response focused on only one of Tennessee's firm services, Rate Schedule FT-BH service, a minor and limited availability firm service as compared to Rate Schedule FT-A service. The proposed tariff language at Article III, Sections 4(j) and 11.11(n) of the GT&C states "Nominations that result in an overlap of contract quantities at a point will be considered out of the path for location restriction purposes."

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[79] Order No. 636-A, FERC Stats. & Regs. Regulations Preambles ¶ 30,950 at 30,585 (1992); Order No. 637-A, FERC Stats. & Regs. Regulations Preambles ¶ 31,099 at 31,592.

This sentence is unqualified, thus it could apply to normal forwardhaul Rate Schedule FT-A services as well as Rate Schedule FT-BH services.

140. As the Commission explained in the April 3 Order and in the Remand Order,[80] the Commission's policy is that when a forwardhaul contract is segmented through a backhaul, the backhaul transaction is considered out-of-path and the forwardhaul transaction is within the path. Similarly, for a shipper with a backhaul service that segments to a forwardhaul service, the forwardhaul service is out-of-path, and the backhaul service is within the path. Tennessee's proposed tariff provision is inconsistent with this policy because it would treat all nominations resulting in an overlap of capacity at a point as out-of-path. Tennessee, therefore, is required to revise the tariff provision in accord with the Commission policy that only the transaction opposite the original transaction is out-of-path.

141. Clarksville protests that Tennessee does not propose to permit Rate Schedule FT-GS customers the right to segment and backhaul to a single point. Tennessee, in its response, states that Rate Schedule FT-GS is a small customer service with volumetric rates. As such, the service does not enjoy the full panoply of Part 284 rights granted two part rate firm shippers.

142. The Commission rejects Clarksville's protest. The *Order on Remand* did not expand the rights of small firm Part 284 customers paying a one-part rate. Rate Schedule FT-GS is a special, subsidized rate schedule that limits availability to customers to 10,000 Dth or less on any day under all services on Tennessee's system. Therefore, the customer could not perform a forward and backhaul to the same point at its full contract demand without exceeding the delivery limitation under Rate Schedule FT-GS.

143. However, under and Tennessee's tariff, Rate Schedule FT-GS customers have flexible receipt point rights,[81] but only flexible delivery point rights to inject gas into

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[80] 99 FERC ¶ 61,017 at P 90-95. See Remand Order, 101 FERC ¶ 61,127 at P 42 & 54.

[81] Section 4.1 of Rate Schedule FT-GS provides that ... any receipt point in Shipper's Transportation Path may be used as a Secondary Receipt Point. Section 27 of Tennessee's GT&C provides that ...the firm transportation path for a firm transportation agreement shall mean the zone of the primary receipt point, the zone of the primary delivery point and all intermediate zones...

storage.[82] Thus, the Commission clarifies that, under this tariff provision, small customers may segment capacity for their own use[83] by using the flexible point rights provided in their rate schedule (including the use of forwardhauls and backhauls) as long as the total volumes delivered does not exceed the delivery limitation under Rate Schedule FT-GS. The customer performing segmentation must pay the small customer volumetric rate for each Dth delivered. Tennessee must file revised tariff sheets to reflect the ability of small customers to segment capacity as discussed herein. Further, to the extent small customers wish to have full Part 284 segmentation and capacity release rights, they may convert to a Part 284 firm service with reservation charges.

144. PSEG and Nashville protest Tennessee use of the word "overlap" in the description of a single delivery point serving a forward and a backhaul segments. PSEG contends that the *Order on Remand* only used the word in contexts that reenforced that use of a single delivery point for both forwardhaul and backhaul segments were not overlaps. Nashville speculates Tennessee chose this language to support its arguments against this concept elsewhere. Notwithstanding, Nashville contends that it has no legitimate place in the compliance filing. Tennessee responds that the word choice was made to be consistent with the rest of its tariff. With this clarification, the Commission rejects the protests.

4. Rights to Primary Points

a. Tennessee's Compliance

145. Tennessee filed tariff sheets that institute rates for segmented primary point capacity as proposed in its August 15, 2000 filing. Tennessee also proposed to restrict segmented capacity holders' rights to request primary points to locations within the Releasing Shipper's capacity path and in the same direction as the Releasing Shipper's contract, and that this primary point capacity would not be subject to further segmentation.

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[82] Section 4.2 of Rate Schedule FT-GS provides: "the Shipper's delivery points shall be the interconnection(s) of Transporter's system and Shipper's system specified in Shipper's Transportation Service Agreement. Shipper may use alternate delivery points within Shipper's Transportation Path on a secondary basis for deliveries to storage."

[83] Customers with one-part rate schedules, however, will not be able to segment capacity through capacity release as provided in Order No. 636. See Order No. 636-B, 61 FERC ¶ 61,272 at 61,998.

b. Protests

146. Louisville protests Tennessee's proposal as contrary to the Commission's goal of enhancing transmission competition and Order No. 637's mandated segmentation. Further, Louisville believes the reservation fees are duplicative of Tennessee's existing reservation fees.

c. Commission Ruling

147. The Commission, in the April 3 Order, rejected Tennessee's proposal to charge rates for segmented primary point capacity, and, as stated above, denied Tennessee's request for rehearing. Tennessee's proposed rates are rejected as not in compliance with the April 3 Order and Order No. 637. Elsewhere in this order the Commission rejected Tennessee's request for rehearing as to treating segmented capacity holders as a different class of customers for the purposes of primary point requests. The Commission finds that Tennessee's proposed tariff restrictions on a segmented capacity holder's right to request primary point capacity is inconsistent with its existing tariff and not required by Order No. 637. Tennessee also proposes to restrict the rights of segmented capacity holders to resegment capacity. Replacement shippers have the same rights as the releasing shippers. Tennessee is directed to file revised sheets to revise proposed Section 11 of its GT&C to allow segmented capacity holder to request primary point capacity and resegment capacity.

5. Mainline Priority at Secondary Points

a. April 3 Order

148. Order 637-A provides that each pipeline must afford a higher priority over mainline capacity to shippers seeking to use a secondary point within their capacity path than shippers seeking to use mainline capacity outside of their path, unless the pipeline can demonstrate that such an approach is operationally infeasible or leads to anti-competitive outcomes on its system.[84]

149. The Commission accepted both Tennessee's proposed definition of capacity path and its proposed restriction path secondary point priority methodology. The accepted method starts with the premise that all within-the-path and within contract demand quantity secondary point nominations should have a priority over out-of-path and

[84] Order No. 637-A at 31,596-98.

interruptible service nominations. While a shipper’s contract primary points determine its capacity path, the secondary priority level of any particular secondary point, within or outside of the path, is based on whether that transaction is moving gas through a capacity restriction point on the pipeline. If a restriction is in the shipper’s capacity path, then the flow will be considered at the higher secondary priority level. If the restriction is outside the shipper’s capacity path but within the nominated path, then the flow will be at a lower secondary priority level. The "restriction model" also separately ranks secondary points. Secondary points within-the-path are scheduled first, followed by secondary points outside the path.

150. Tennessee noted that certain aspects of its proposal will require time to implement. Therefore, the April 3 Order required Tennessee to provide an implementation plan.

b. Tennessee's Compliance

151. Tennessee proposes to implement systemic changes related to segmentation, primary point rights, and secondary point priority in two phases. The first phase would implement elevation of secondary points rights to primary utilizing internal work-arounds and/or manual processes. However, a full automated and tested system for all the components would not be available until April 1, 2003.

c. Commission Ruling

152. Since it is now beyond the April 1, 2003 implementation date Tennessee cites, this is no longer an issue.

6. Discount Provisions

a. Tennessee's Compliance

153. Tennessee filed tariff sheets in compliance with the April 3 Order. In order to benefit customers, to allow Tennessee to protect the integrity of its contracts, and to permit a timely response to requests for discounts, Tennessee proposes to include in its tariff a list of categories to analyze whether a shipper is similarly situated. This list is intended to exclude certain contracts from consideration. Negotiated rate contracts will not be permitted to transfer discounts. For the remaining contracts, the analytical categories are as follows:

- Effective date. Tennessee will only compare contracts with like terms (e.g., daily, monthly, annual or seasonal) and vintage. Tennessee defines vintage as contracts sold within the last 30 days of the requested agreement. Older contracts will not be used as a basis upon which a request for discount may be granted.

- Transportation path, including type of service, receipt and delivery points and zones.

- Quantities and direction of flow. Contracts with quantities that vary from the requested level by 10 percent or more will not be considered. Tennessee also notes that the Commission has approved Tennessee's tariff provision which identifies quantity as a basis upon which Tennessee may grant a discount.[85] Tennessee seeks confirmation that this tariff provision remains valid. Tennessee submits that this provision is applicable to segmented capacity as well as secondary nominations, as well as original volumes. In this way, a shipper's desire to segment can be considered in the initial negotiation. Tennessee argues that this provides greater shipper protection than the policy of applying the maximum rate to all contracted volumes if a shipper segments. Tennessee also claims this proposal is consistent with Commission approved negotiated rate contracts that provide for the termination of the negotiated rate in the event a secondary point is used.

- Point by point: If the requested discount passes these analytical categories, then Tennessee will progress to a point by point analysis of granting the original discount.

b. Protests and Answer

154. Louisville and Dominion LDCs believe that Tennessee's exclusion of negotiated rate contracts is not justified. Louisville fears that Tennessee will simply implement discounts as negotiated rates. With regard to retaining discounts at a new point, Louisville protests the various categories of Tennessee's proposed analytical categories. Louisville believes the result will require nearly identical contracts, potentially resulting in Tennessee denying virtually any request for discount retention. Dominion LDCs believe that several of the categories are arbitrary. Further, Dominion LDCs believe Tennessee is attempting to shift the rebuttable presumption of the Commission's policy back to the customers. They argue that the end result of these restrictions and screens

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[85] Citing Tennessee Gas Pipeline Company, 84 FERC ¶ 61,340 (1998), *order denying reh'g*, 85 FERC ¶ 61,441 (1998).

would be contrary to Order No. 637's goals to enhance competition. These protestors request that the Commission reject Tennessee's compliance proposal. Tennessee, in response, states that it has simply provided the list of criteria it will use to evaluate requests to transfer discounts.

c. Commission Ruling

155. The Commission will reject Tennessee's proposed list of conditions under which contracts will be excluded from consideration as being similarly situated. The Commission has rejected pipeline proposals for "hard and fast" rules for determining whether shippers are similarly situated. As the Commission stated in Williams,

> the pipeline must decide at the time a shipper requests to retain its discount whether the segmented or secondary point transaction is similarly situated with the transaction already receiving the discount at the secondary point. In making its determination, the pipeline must weigh all relevant factors rather than applying a hard and fast rule.[86]

As discussed below, Tennessee's proposed rules for excluding discount requests are overly broad.

i. Negotiated Rate Contracts

156. Tennessee's proposed tariff language would prevent negotiated rate shippers from ever receiving the benefit of the CIG/Granite State policy, when the negotiated rate shipper shifts to a point where a discount is given. Such a blanket prohibition on negotiated rate shippers ever taking advantage of the CIG/Granite State policy goes too far. That policy requires that, where a pipeline gives one shipper a discount at a point, it must permit other similarly situated shippers using that point on a secondary basis to pay the higher of the discounted rate or their contract rate.

157. In many cases, a negotiated rate shipper may properly be treated as not similarly situated to the discounted rate shipper, and thus not entitled to the benefit of the CIG/Granite State policy. For example, the Commission held in Horizon[87] that when a

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[86] Williams Gas Pipelines Central, Inc., 100 FERC ¶ 61,034 at P 56 (2002).

[87] Horizon Pipeline Co., 101 FERC ¶ 61,247 (2002) (Horizon). See also,
(continued...)

negotiated rate shipper's negotiated rate is a formula rate, or uses a different rate design, the pipeline could contend that such a rate is a transaction that is not similarly situated to the discount situation. Therefore, such a negotiated rate could be limited to specific points, without regard to discounts that may be offered at other points. However, there may be other situations where the negotiated rate shipper is similarly situated to a discounted rate shipper. For example, the Commission has permitted pipelines to negotiate a discounted rate with a shipper and then convert it to a negotiated rate, so as to be able in its next rate case to reflect the discount portion of the rate in the discount adjustment to its rate design volumes.[88] In that case, it could be appropriate to treat the negotiated rate shipper as similarly situated to a discounted rate shipper for purposes of applying the CIG/Granite State policy.

ii. Effective Date

158. Tennessee proposes to only compare contracts with like terms and vintage, defining vintage as contracts sold within the last 30 days of the requested discount request. The Commission finds that such a limitation will not in all situations define when two shippers are similarly situated. For example, if Tennessee provides a discount to a fuel switchable customer in November, it is not clear that a fuel switchable customer applying to change points in December would not be similarly situated. The Commission is not ruling out the possibility that, in some circumstances, Tennessee could find that such customers are not similarly situated, but Tennessee cannot simply define such transactions as dissimilar in its tariff; it must provide a good explanation for its determination.

iii. Transportation Path and Type of Service

159. Tennessee proposes that shippers with a different transportation path, including type of service, receipt and delivery points and zones would not be considered similarly situated. The Commission has explained why distinctions in type of service (i.e., firm versus interruptible) may not always be a legitimate basis for denying a discount. As the Commission stated in Gulf South:

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[87](...continued)
CenterPoint Energy-Mississippi River Transmission Corporation, 102 FERC ¶ 61,216 (2003).

[88]Midwestern Gas Transmission Co., 101 FERC ¶ 61,310 at 62,244-45 (2003) (Midwestern).

> Since the use of alternate points by firm shippers through capacity release or other transactions compete with the use of pipeline interruptible service, it is appropriate to consider discounts to interruptible shippers in determining whether the shippers are similarly situated. Therefore, if a pipeline is granting discounts at a point, whether the service to that point be firm or interruptible, the rebuttable presumption comes into play, regardless of whether the proposed new service is of the same character as the service already receiving the discount. The mere fact that one shipper is using firm service while another is proposing to use interruptible service should not be an absolute bar in determining whether the shippers are similarly situated for the purpose of granting discounts.[89]

160. Similarly, merely because shippers may have a different primary transportation path is not sufficient to justify a finding that shippers are not similarly situated. For example, given the ability to use flexible receipt points, one shipper's use of a receipt point different from that of another does not necessarily mean that such shippers are not similarly situated at the delivery point at which the discount is given. While in some cases, changes in transportation paths may be relevant to the discount decision, in other cases, it may not be, and Tennessee cannot adopt a rule that automatically finds that discount requests with different transportation paths are always deemed non-similar.

iv. Quantity Differences

161. Tennessee proposes that when quantities differ from the requested level by 10 percent, the shippers will not be considered similarly situated. Tennessee cites to its tariff provision which allows it to use quantity as a basis for providing discounts.

162. In the first place, Tennessee's tariff refers to discounts provided for volumes, not contract quantities.[90] But more importantly, this provision is overbroad, because it is not limited only to those cases in which volumes were the basis of granting the discount. For example, Tennessee may grant a discount based on the customer's status as fuel switchable. It would not be appropriate to deny a request to change points to another fuel

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[89] Gulf South Pipeline Company, 98 FERC ¶ 61,278 at 62,169 (2002). See also, CenterPoint Energy-Mississippi River Transmission Corporation, 102 FERC ¶ 61,216 at P 27 (2003); Reliant Energy Gas Transmission Company, 100 FERC ¶ 61,172 at PP 13-14 (2002).

[90] Tennessee Gas Pipeline Company, 84 FERC ¶ 61,340 (1998).

switchable customer, simply because their contract levels were different. While, in appropriate circumstances, quantities may be a legitimate basis for distinguishing customers, it cannot be used as a hard and fast rule to automatically disqualify requests to change points.

7. Imbalance Services

163. Order No. 637 requires pipelines with imbalance penalty provisions in their tariffs to provide, to the extent operationally practicable, imbalance management services, such as park and loan service. Pipelines are prohibited from giving undue preference to their own balancing services over such services that are provided by a third party.[91]

164. Tennessee has operational balancing agreements (OBAs) at each point on its system either under or subject to Rate Schedules LMS-PA and LMS-MA. Tennessee allocates scheduled volumes to each point on its system and calculates imbalances on a point by point basis. Shippers are billed on scheduled quantities, not actuals. Reconciliation of the difference between scheduled volumes and actuals are performed through the OBAs. Under Rate Schedules LMS-PA and LMS-MA, the point operator has the ability to manage imbalances through various nominated services, swinging on storage, netting and trading, or cashing out the imbalance. The point operator settles its imbalance position with Tennessee, and passes through the costs of settling the imbalance to the various shippers under the terms of the shippers' agreement with the point operator.

a. April 3 Order

165. The April 3 Order accepted several of Tennessee's proposals to improve and expand imbalance management services. However, the Commission directed Tennessee to remove a restriction on trading across a posted point of restriction.

166. Tennessee stated it would reduce the transportation fee to the greater of the rate designated in the transportation agreement or the intra- or inter-zone Rate Schedule FT-A usage charge, provided the Commission approved Tennessee's proposed unscheduled overrun proposal. As the Commission did approve the proposal, the Commission directed Tennessee to reflect the rate reduction in its compliance filing.

[91] 18 C.F.R. § 284.12(c)(2)(iii) (2003).

b. Tennessee's Compliance

167. Tennessee filed tariff sheets that implement its proposed imbalance management services, permit imbalance trading across a posted point of restriction, and reduce the transportation rate associated with certain traded imbalances.

c. Protests

168. ConEd notes that the April 3 Order required Tennessee to clarify the charges applicable to OBA Transportation Service (OTS). ConEd notes that Tennessee did include some clarification, but ConEd believes that additional clarification is necessary. Specifically, ConEd requests that the Commission require Tennessee to clarify the applicability of the charge for quantities within a shipper's Daily Swing Quantity (DSQ), but in excess of schedule volumes. ConEd notes that some of the explanation is in Tennessee's compliance cover letter. However, these explanations are inadequate, and the OTS provisions should either cross-reference the applicable Rate Schedule LMS-MA provisions or add rate sheets that succinctly list the rates, including penalties and formulas.

d. Commission Ruling

169. The clarification requested by ConEd is unnecessary. Section 4 of Rate Schedule LMS-MA consistently states that quantities in excess of a balancing parties DSQ shall be assessed an OBA charge. The section does not provide for assessing a charge on any other gas quantities. An appropriate cross-reference to Section 7(c)(iii) is made. Section 7(c)(iii) explains that the charges are applicable to quantities within a shipper's DSQ but in excess of scheduled volumes.

8. Penalties

170. Order No. 637 requires that a pipeline's penalties follow three principles.[92] First, a pipeline may include transportation penalties in its tariff only to the extent necessary to prevent the impairment of reliable service. Second, a pipeline must credit to shippers all revenues from all penalties net of costs. Third, a pipeline must provide to shippers, on a timely basis, as much information as possible about the imbalance and overrun status of each shipper and the imbalance of the pipeline's system as a whole.

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[92] 18 C.F.R. § 284.12(c)(2)(v) (2003).

a. April 3 Order

171. The April 3 Order addressed several penalty issues. The Commission accepted Tennessee's proposed OTS service to replace the MAV penalty, conditioned upon Tennessee clearly stating the rates and volume calculations in its tariff. The Commission required Tennessee to either explain why Rate Schedules IS's and PAL's contract termination penalty provisions are not similar, or provide for tolling of penalties for volumes nominated but not scheduled. With regard to Rate Schedules IS and FS, the Commission found that Tennessee had not justified why certain penalties should apply to imbalances and ratchet overruns during non-critical periods. The Commission required Tennessee to submit revised tariff sheets, or provide support for why changes are unnecessary. The Commission also required Tennessee to provide clarification with regard to unscheduled flow penalties and their interrelationship with the OBAs of Rate Schedules LMS-MA and LMS-PA, or OTS service.

172. Due to Tennessee's retention of the Action Alert as another OFO level and elimination of the daily variance penalty, the April 3 Order required Tennessee to change the basis of the Action Alert penalty from the daily scheduling variance charge under Rate Schedule LMS-MA ($0.3936 per Dth) or LMS-PA ($0.1099 per Dth). The Commission also concluded that Tennessee's proposed change to $25 per Dth from $15 per Dth for violation of the highest OFO level, Balancing Alerts, was neither required by Order No. 637 nor adequately supported by Tennessee's claim that it is necessary to prevent gaming.

b. Tennessee's Compliance

173. Tennessee filed tariff sheets to comply with each of the changes required by the April 3 Order. Tennessee proposes to provide for tolling of penalties for volumes nominated but not scheduled under Rate Schedules IS and PAL. With regard to Rate Schedules IS and FS, Tennessee proposes to not assess imbalances and ratchet overruns during non-critical periods. Rather, Tennessee proposes to charge shippers the maximum Rate Schedule PAL rate for overdraws of a storage account, and, if there is still a negative balance at the end of the month, the excess amounts will be treated as a purchase by the shipper. The purchase price will be equal to the highest daily spot price during the month. Tennessee states that this Rate Schedules IS and FS proposal eliminates the penalty provisions during non-critical periods, and assesses charges based on equivalent services. Due to the elimination of the daily variance penalty, Tennessee proposes to use four times the Rate Schedule PAL rate for violations of the OFO Action Alert. The revised tariff sheets also provide for a $15 per Dth charge for violation of the Balancing Alerts level.

174. Finally, Tennessee filed clarifying tariff language that removes unscheduled flow provisions from deliveries because such quantities will be captured by the new OTS service under Rate Schedule LMS-MA. With regard to unscheduled receipts, Tennessee also proposes to eliminate the unscheduled flow penalties, and proposes to replace the penalties with a default Rate Schedule PAL service for shippers who do not take immediate action upon notice. The currently effective unscheduled flow penalties for receipts are Tennessee purchasing the gas at 50 percent of the regional daily index for gas, and $15 per dth plus confiscation of the gas if the responsible party does not take corrective action.

c. Protests

175. The Indicated Shippers and Dominion LDCs state that the April 3 Order required Tennessee to impose a Rate Schedule PAL-based Action Alert penalty of up to $1.48 per dth.[93] As the Rate Schedule PAL rate is excessive, the Indicated Shippers argue that the resulting Action Alert penalty is also excessive. The Indicated Shippers state that, based on Texas Eastern II,[94] the Commission should require a reduction in Tennessee's Rate Schedule PAL rate. Indicated Shippers claim that in Texas Eastern II the Commission required the removal of access area costs from Texas Eastern's PAL service rate. Indicated Shippers assert that Tennessee's Rate Schedule PAL rate includes similar transmission costs, as it includes a system average IT rate. Therefore, the Indicated Shippers submit that Tennessee's Rate Schedule PAL rate is based on a method that has been reconsidered and modified. The Indicated Shippers propose that Tennessee's Rate Schedule PAL rate be modified to include only the intra-zone IT rate.

176. The Indicated Shippers and Dominion LDCs argue that the Commission's appropriate rejection of Tennessee's proposed increase of the Balancing Alert penalty stands in sharp contrast to the approval of the increased Action Alert penalty. They submit that the proposed increase in the Action Alert penalty is unsupported and should be rejected like the increase in the Balancing Alert penalty. Dominion LDCs suggest, given the rationale of the April 3 Order, the Commission should require Tennessee to simply replace the daily scheduling variance charge with the PAL rate to calculate the Action Alert penalty. This would result in an Action Alert penalty of twice the PAL rate for scheduled imbalances in excess of 10 percent. PGC also argues that the Commission's

[93] In their protest to Tennessee's compliance filing, Dominion LDCs note that the current Action Alert penalty is twice the daily scheduling variance charge.

[94] Texas Eastern Transmission, L. P., 98 FERC ¶ 61,215 at 61,840-841 (2002) (Texas Eastern II).

proper rejection of Tennessee's proposed increase to the Balancing Alert penalty demonstrate that approval of the Critical Day penalties was not well reasoned. PGC is concerned that imposing a penalty when Tennessee's system is long is not operationally justified.

177. PGC asserts that Tennessee's OFO Structure and OFO penalties do not meet the requirements of Order No. 637 and must be rejected. PGC argues that Tennessee has not provided evidence that its graduated system of penalties will reduce the incidences of OFOs or that the amount of penalty for each level of OFO is justified. Dominion LDCs contend that Tennessee has not met the Order No. 637 requirement that pipelines narrowly design penalties to deter only conduct that is actually harmful to the system and the Commission has stated that Order No. 637 was not an opportunity for pipelines to file to increase penalties or make their penalty provisions more stringent.

178. Dynegy states that Tennessee proposes that if a storage shipper withdraws excess gas quantities and does not eliminate the deficiency by the end of the month, the excess amounts shall be deemed purchased by the shipper at the highest daily spot price for the month published in Gas Daily. Dynegy argues that Commission policy precludes the use of the highest or lowest daily spot price during a month for cashouts.[95] Dynegy submits that the index price should be the average of the weekly prices.

179. Dynegy also asserts that Tennessee should not be allowed to allocate unscheduled flows to a park and loan agreement, if the responsible party does not take corrective action after notification. Dynegy argues that allowing a pipeline to require a shipper to use its imbalance management services is inconsistent with the Commission's policies requiring that a shipper have the opportunity to obtain imbalance management services from third party provider and unbundling of services and allows a pipeline to unfairly exercise its market power. Tennessee responds it makes a transfer to a park and loan agreement only when gas flowed without a nomination and the shipper refused to take corrective action after notice to do so and the proposal only recovers for the service provided. Tennessee states that the revised proposal also eliminates the unscheduled flow penalties and does not apply to deliveries.

[95] See Algonquin Gas Transmission Co., 98 FERC ¶ 61,211 at 61,780 (2002) and Texas Eastern Transmission, LP, 98 FERC ¶ 61,215 at 61,840 (2002).

d. Commission Ruling

180. The Commission finds that Tennessee's filing generally complies with the April 3 Order. However, as discussed below, Tennessee must make certain modifications to its revised tariff sheets.

181. The April 3 Order did not require Tennessee to impose a PAL-based penalty of up to $1.48/Dth for Action Alerts. The April 3 Order accepted Tennessee's offer in response to comments to retain the Action Alert as the lowest OFO level.[96] The order also stated that, since the current Action Alert is based on the daily variance penalty which is being replaced by the Daily Imbalance Charge, Tennessee must revise its tariff sheet to reflect the current proposal.[97] In response, Tennessee has proposed an Action Alert penalty of up to four times the Rate Schedule PAL rate. Tennessee's current maximum PAL rate is $0.3695. Tennessee's current Action Alert Penalty is twice the current daily variance charge which is $0.3936 for Rate Schedule LMS-MA. Therefore, Tennessee's proposed Action Alert penalty may be almost twice its existing Action Alert penalty. As discussed in the April 3 Order, Order No. 637 was not an opportunity to increase penalties.[98] Tennessee has not justified the increase in its Action Alert penalty. Therefore, Tennessee is directed to reduce its proposed Action Alert penalty to a level no greater than its existing Action Alert penalty.[99] As the Commission is not requiring Tennessee to base its Action Alert Penalty on the Rate Schedule PAL rate, Indicated Shippers' objection to the PAL rate design is moot.

182. The Commission agrees that the index price for excess withdrawals from storage should be the average of the weekly spot prices. The Commission has previously found that the use of daily pricing can be too punitive as the basis for PAL penalties and cashout mechanisms. The Commission has stated that the highest or lowest daily price can vary a great deal from the actual cost of the gas when the imbalance was incurred and may

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[96] 99 FERC ¶ 61,017 at P 231 (2002).

[97] 99 FERC ¶ 61,017 at P 244 (2002).

[98] 99 FERC ¶ 61,017 at P 246 (2002).

[99] The Commission notes that Tennessee's proposed *pro forma* service agreement tariff language at Sheet Nos. 587, 596, and 605 still reference daily variance charges. Tennessee is directed to correct this oversight in its compliance filing.

unduly increase the penalties for imbalances, which is contrary to Order No. 637.[100] This reasoning also applies to charges for excess withdrawals from storage. Accordingly, Tennessee is required to file revised tariff sheets to base its penalty on the average weekly spot prices.

183. The April 3 Order directed Tennessee to clarify the role of unscheduled flow penalties given the other changes it was making to imbalance management and penalty structure. Tennessee clarifies that unscheduled flows are accommodated by Rate Schedule LMS-MA's imbalance management mechanisms, and it proposes tariff language to eliminate unscheduled flow penalties from deliveries.[101] However, Tennessee explains that unscheduled flows could still occur at receipt points. The proposed tariff provides that if a shipper or OBA operator nominates zero, and unscheduled deliveries to Tennessee are made, then the difference is an unscheduled flow.

184. Imbalances occur as a result of an unscheduled difference between scheduled and actual flows. Tennessee fails to explain why it is important to identify unscheduled flows originating from points with scheduled quantities of zero, as compared to points with scheduled quantities greater than zero. Rate Schedule LMS-PA provides for the management of imbalances, and Tennessee has failed to justify creating a separate classification of imbalances with separate imbalance management rights and penalties. The Commission rejects Tennessee's proposal, and requires Tennessee to remove Section III.8.2 from its GT&C. Therefore, Dynegy's protest on this issue is moot.

9. Penalty Revenue Crediting

a. April 3 Order

185. The April 3 Order found that certain contract termination imbalance penalties were not addressed by Tennessee's penalty revenue crediting provisions; that the unscheduled flow penalty crediting was unclear; and that all received net penalty revenues should be credited back to non-offending shippers, including interruptible and short term firm shippers. Further, the Commission accepted Tennessee's offer to absorb all the costs

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[100] See Algonquin Gas Transmission Co., 98 FERC ¶ 61,211 at 61,780 (2002) and Texas Eastern Transmission, LP, 98 FERC ¶ 61,215 at 61,840 (2002). See also Texas Gas Transmission Corp., 96 FERC ¶ 61,318 (2001), reh'g denied, 97 FERC ¶ 61,349 (2001).

[101] Proposed Sheet No. 319.

involved in the Daily Imbalance Charge until its next rate case. If penalty revenue credits where to be returned annually, the Commission required Tennessee to include interest.

b. Tennessee's Compliance

186. Tennessee filed tariff sheets that credit all penalty revenues to all non-offending shippers. Tennessee clarifies that, given its unscheduled flow clarification and revisions discussed earlier in this order, the issue is now moot. Tennessee stated, but did not include as part of its proposed tariff language, that it would calculate interest on annual penalty revenue balances. Tennessee also proposes to revise its pro forma filing to provide that Tennessee shall credit penalty revenues to eligible shippers in the seventh month following the end of the annual crediting period. Tennessee explains that the seven-month period following the crediting period allows for any prior period adjustments to be made before the credits are issued. The pro forma filing stated Tennessee would credit the eligible shippers in the invoice following the first production month following the annual period for which the disbursements were made.

c. Protests

187. Dominion LDCs request that the Commission require Tennessee to include interest as part of the penalty revenue crediting mechanism. In reply, Tennessee contends that it stated in the compliance filing that it will comply with all applicable Commission regulations regarding interest on penalty revenue balances and there is no need to replicate those regulations in its tariff.

188. Dominion LDCs are also concerned that the revenue crediting mechanism will result in no credits to former customers whose contracts expire prior to the disbursement billing period. Dominion LDCs request that the Commission require Tennessee to provide that these customers receive a direct cash disbursement. In its answer, Tennessee agrees to provide an applicable cash disbursement to any eligible shipper that had a contract terminate during the crediting or subsequent seven month period.

189. Indicated Shippers protest that some rate schedules subject to OFO penalties were omitted from eligibility for penalty revenue crediting. In response, Tennessee agrees to revise Article XXXVIII to add rate schedules liable for OFO penalties that were inadvertently omitted from the penalty revenue crediting section.

d. Commission Ruling

190. With the modifications required here, the Commission finds that Tennessee has complied with the April 3 Order. Consistent with the Commission's ruling in TransColorado, Tennessee is required to file to revise its tariff filing, within 30 days of the issuance of this order, to provide that it will credit penalty revenues to eligible shippers within 60 days after the end of the annual crediting period.[102] Tennessee's proposed revision providing for seven months was not required by the April 3 Order. Nor has Tennessee provided any operational or business reason for the seven-month delay. In accordance with the Commission's policy to remove incentives for pipelines to generate penalty revenues, Tennessee is required to revise its tariff to provide that it will accrue and credit interest on penalty revenues prior to crediting shipper invoices.[103] Further, while Tennessee has indicated that it will comply with Commission regulations requiring pipelines to pay interest on annual penalty revenue balances, the Commission directs Tennessee to make this explicit in its tariff.

191. Tennessee is also directed to file revised tariff sheets to indicate that Tennessee will provide an applicable cash disbursement to any eligible shipper that had a contract terminate during the crediting period, or subsequent period before disbursement, and revise Article XXXVIII to add rate schedules liable for OFO penalties but omitted from the penalty revenue crediting section as Tennessee agreed to in its answer.

10. OFOs

a. April 3 Order

192. Tennessee proposed to require, as part of the operational flow order, adjustments to deliveries and receipts "in uniform hourly quantities during the day." Since Tennessee has other tariff provisions to address situations where system operations are such that firm service cannot be reliably provided, the April 3 Order required Tennessee to either remove the uniform hourly flow requirement, or limit it to those services that are subject to the requirement under the terms of their rate schedule.

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[102] TransColorado Gas Transmission Company, 96 FERC ¶ 61,189 at 61,826 (2001).

[103] See, e.g., TransColorado Gas Transmission Company, 96 FERC ¶ 61,189 at 61,826 (2001) and Texas Eastern Transmission, L.P., 98 FERC ¶ 61,215 at P 145 (2002).

b. Tennessee's Compliance

193. Tennessee filed a tariff sheet that limits the application of an OFO requiring adjustments to deliveries and receipts in uniform hourly quantities to those rate schedules containing such a requirement. Revised Article VIII, Section 4.4 of Tennessee's GT&C states in part,"Transporter can further require a Customer taking service pursuant to Rate Schedule FT-A, FT-BH, FT-IL, IT, LMS-MA, NET, 284, PTR, PAT, SS-E, SS-NE, or IT-X to adjust their hourly quantities such that the customer will deliver and receive gas in uniform hourly quantities during the day."

194. To avoid confusion and extensive rewrites, Tennessee proposes to retain the label Balancing Alerts for its final OFO tier. Action Alerts, Balancing Alerts, and Critical Days One and Two may be collectively referred to as OFOs.

c. Protests

195. Several protesters argue that Tennessee must remove or revise the uniform flow requirement included in its OFO provisions. The New England LDCs protest that Tennessee's OFO hourly flow language goes beyond what the Commission required and what is provided for in the tariff. As proposed, Article VIII, Sections 4.4 and 5.2 of the GT&C would require Rate Schedule FT-A and the other listed rate schedules to deliver and receive gas in uniform hourly quantities. However, the New England LDCs note that, with the exception of Rate Schedule NET, these Rate Schedules' flow requirements are not as restrictive, since they include the phrase "as nearly as practicable." The New England LDCs believe Tennessee overreached, and the proposed language should be rejected as not in compliance with the April 3 Order. The New England LDCs explain this language is significant, since they rely on Rate Schedule FT-A service to meet their fluctuating needs of their temperature sensitive load throughout the day and they have operated in this manner since the inception of their service from Tennessee. Piedmont Natural Gas Company, Inc. supports the New England LDCs' comments. The New York State Electric & Gas Corporation makes similar arguments. KeySpan also argues that Tennessee should be required to clarify that its Critical Day and Balancing Alert Provisions only permit Tennessee to require uniform hourly flows "as nearly as practicable" consistent with Section 4.11 of Rate Schedule FT-A.

196. The Dominion LDCs complain that Tennessee has not shown that the uniform hourly flow language does not degrade firm service, even though the April 3 Order stated Tennessee should not include OFO requirements that degrade firm service. They assert that the proposed revisions do degrade firm service, since Rate Schedule FT-A, for

example, entitles shippers to additional hourly flexibility on an operationally available basis and, therefore, do not contain uniform hourly flow requirements.

197. Clarksville requests that Tennessee add the phrase "under one or more of the above-listed rate schedules" in the last sentence of Sections 4.4 and 5.2 before the words in uniform hourly quantities during the day. Clarksville states the addition is necessary to clarify that service under Rate Schedule FT-G or FT-GS is not subject to uniform hourly flow requirements, even if the customer also receives service pursuant to Rate Schedule IT which is subject to such requirements. Clarksville states the additional language is necessary, since Tennessee's proposal limits OFO hourly limits to customers that take service pursuant to the listed rate schedules rather than service under the listed rate schedules.

198. Tennessee answers that the protests are contrary to the April 3 Order, the plain language of its tariff, and prior Commission orders.[104] Tennessee insists that the tariff provision does not place a further restriction on shippers than is already contained in their respective rate schedules. Tennessee states it will have already determined that variation from uniform hourly flows are not operationally feasible at a point for a certain length of time when it invokes an OFO. Tennessee contends the requested "practicability" restriction is unnecessary as the limitation is already essentially included in Article VIII, Sections 4.5 and 5.3 of its GT&C which permits an OFO recipient to demonstrate it is unable to comply with an OFO.

199. PGC argues that the failure to require Tennessee to notify shippers by fax of Critical Days renders the proposed notification method insufficient. Further, PGC requests that the Commission direct Tennessee to clarify that the proposed revision requiring Tennessee to give notice of Critical Days by telephone was intentional, because it is a necessary backup in case of computer system failure.

d. Commission Ruling

200. Tennessee's proposed revisions to its OFO provisions generally comply with the April 3 Order. However, Tennessee must make some modifications to its proposal. Tennessee is required to add the words "as nearly as practicable" to its OFO hourly flow restrictions related to all of the listed rate schedules except Rate Schedule NET. This will

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[104] See Tennessee, 76 FERC ¶ 61,022 at 61,138 (1996); Tennessee, 80 FERC ¶ 61,070 at 61,244 (1997); Tennessee, 94 FERC ¶ 61,224 (1999); and Tennessee, 100 FERC ¶ 61,151 at P 5 (2002).

make the OFO hourly flow restriction consistent with the restrictions in the listed rate schedules and ensure that service under the listed rate schedules is not degraded. Tennessee contends the revision is unnecessary since the "practicability" restriction is essentially already included in Article VIII, Sections 4.5 and 5.3 of its GT&C. However, Tennessee has not adequately demonstrated that the exceptions to the hourly flow restrictions included in Article VIII, 4.5 and 5.3 have the same affect as the as nearly as practicable language. Furthermore, if Tennessee is correct, it should not have a problem with adding the practicability language to Article VIII, Sections 4.4 and 5.2. Tennessee is also required to add the phrase "under one or more of the above-listed rate schedules" in the last sentence of Sections 4.4 and 5.2 before the words in uniform hourly quantities during the day. Clarksville is correct that Tennessee's proposal could be interpreted to limit OFO hourly flows for customers that take service pursuant to the listed rate schedules rather than imposing hourly flow limits on service provided under the listed rate schedules. The limits must apply to the service pursuant to the listed rate schedules, not to the customers.

201. Tennessee's uniform hourly flow provisions, as modified above, do not degrade firm service. The Commission has previously found that the hourly take flexibility under Tennessee's Rate Schedule FT-A can only be utilized if operationally feasible.[105] In addition, as discussed in the rehearing section above, the Dominion LDCs acknowledge that the ability of Tennessee's Rate Schedule FT-A shippers to deliver or receive gas at greater than a uniform hourly flow is subject to Tennessee's operating conditions. Since the uniform hourly flow provisions in question apply during Critical Days and Balancing Alerts OFOs which are issued when operational conditions on Tennessee's system are threatened, it is clear that Tennessee will impose the flow restriction only when such action is required by operating conditions. Therefore, the OFO uniform hourly flow provisions are consistent with the provision of Rate Schedule FT-A (and the other listed rate schedules with similar hourly flow provisions), and service under the rate schedules is not degraded.

202. The Commission will not require Tennessee to revise its proposal to provide that Tennessee will notify shippers of Critical Days by fax as PGC requests. The Commission's regulations require a pipeline to give notice of OFOs on its web site and to give notice of such notices, at the choice of the affected party either by Interne e-mail or directly to the party's URL address.[106] Tennessee's proposed tariff revisions are consistent with the regulations. In addition, as discussed in the rehearing section of this

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[105] Tennessee, 100 FERC ¶ 61,151 at P 5 (2002).

[106] 18 C.F.R. § 284.12(c)(3)(vi) (2003).

order, Tennessee will also notify customers of Critical Days by telephone. This method of notification is sufficient. Tennessee is not required to clarify that the revision in the compliance filing to include notification of Critical Days by telephone was intentional as requested by PGC.

III. Conclusion

203. The Commission finds that Tennessee, subject to making the revision directed by the Commission above, has largely complied with the requirements of Order No. 637. Accordingly, within 30 days of the date of this order, Tennessee is directed to file substitute tariff sheets.

The Commission orders:

(A) Requests for rehearing are granted or denied, as discussed above.

(B) The tariff sheets are conditionally accepted effective September 1, 2003, or rejected as shown on Appendix A.

(C) Tennessee is directed to file substitute tariff sheets in compliance with this order within 30 days of the date of this order.

By the Commission.

(S E A L)

Linda Mitry,
Acting Secretary.

Appendix A

Tennessee's Proposed Compliance Tariff Sheets
Accepted Effective September 1, 200s3, unless otherwise noted

Docket No. RP00-477-003, et al.
FERC Gas Tariff
Fifth Revised Volume No. 1

Original Sheet No. 20A
Original Sheet No. 23A.01 */
Original Sheet No. 23C.01 */
Original Sheet No. 23E.01 */
Original Sheet No. 26B.01 */
Seventh Revised Sheet No. 28
Fourth Revised Sheet No. 95B
Fifth Revised Sheet No. 100
Third Revised Sheet No. 101
Third Revised Sheet No. 106
First Revised Sheet No. 110A
Fifth Revised Sheet No. 153
Third Revised Sheet No. 155
Ninth Revised Sheet No. 161
Fourth Revised Sheet No. 162
First Revised Sheet No. 162A
Tenth Revised Sheet No. 167
Fifth Revised Sheet No. 168
Ninth Revised Sheet No. 173
Third Revised Sheet No. 174
Second Revised Sheet No. 202
Fifth Revised Sheet No. 203
Ninth Revised Sheet No. 204
Eighth Revised Sheet No. 205
Eighth Revised Sheet No. 205A
Fifth Revised Sheet No. 205B
Eighth Revised Sheet No. 206
Seventh Revised Sheet No. 207
Fifth Revised Sheet No. 207A
Ninth Revised Sheet No. 209
First Revised Sheet No. 209.01
Fifth Revised Sheet No. 209B
Fourth Revised Sheet No. 209C
Fourth Revised Sheet No. 209D
Third Revised Sheet No. 209E
Fourth Revised Sheet No. 209F
Fourth Revised Sheet No. 209I
Fourth Revised Sheet No. 210
Fifth Revised Sheet No. 211
Fourth Revised Sheet No. 211A
Ninth Revised Sheet No. 212
Fifth Revised Sheet No. 213
Fourth Revised Sheet No. 216
Sixth Revised Sheet No. 217
Fourth Revised Sheet No. 219A
Fourth Revised Sheet No. 228
Second Revised Sheet No. 229
Fourth Revised Sheet No. 234
First Revised Sheet No. 235
First Revised Sheet No. 236
Second Revised Sheet No. 240
First Revised Sheet No. 241
Eleventh Revised Sheet No. 301
Fifth Revised Sheet No. 304
Third Revised Sheet No. 304A
Twelfth Revised Sheet No. 305
Original Sheet No. 305A
Eleventh Revised Sheet No. 316
Original Sheet No. 316A
Eleventh Revised Sheet No. 317
Tenth Revised Sheet No. 318
Eighth Revised Sheet No. 319*/

Seventh Revised Sheet No. 319A
Seventh Revised Sheet No. 334 */
Fourth Revised Sheet No. 334A */
Fifth Revised Sheet No. 339A */
Original Sheet No. 339B */
Sixth Revised Sheet No. 357
Fourth Revised Sheet No. 358
Third Revised Sheet No. 359
Third Revised Sheet No. 360
First Revised Sheet No. 360A
Second Revised Sheet No. 361
Original Sheet No. 361A
Fifth Revised Sheet No. 406
Fifth Revised Sheet No. 406A
Third Revised Sheet No. 406B
First Revised Sheet No. 414
Original Sheet No. 415
Sheet Nos. 416 - 502 - Reserved
Second Revised Sheet No. 587
Second Revised Sheet No. 596
Third Revised Sheet No. 605
First Revised Sheet No. 613

Docket No. RP00-183-000
FERC Gas Tariff
Fifth Revised Volume No. 1

Seventh Revised Sheet No. 314C */
Eleventh Revised Sheet No. 315
Substitute Fifth Revised Sheet No. 339A

*/ Rejected

Appendix B

Docket No. RP03-183-000
List of Motions to Intervene, Protests and Comments

Party	Protest/ Comments	Late
Amerada Hess Corp.		
Chevron U.S.A. Inc.		
Clarksville	X	
Conoco, Inc.		
Consolidated Edison Co. of New York, Inc., and Orange and Rockland Utilities, Inc.		
Dominion LDCs		
Duke Energy Trading and Marketing, LLC		
East Tennessee Group		
ExxonMobile Gas Marketing Co., Div. of Exxon Mobile Corp.		
Illinois Municipal Gas Agency		X
Indicated Shippers (no motion to intervene, simply a protest)		X
KeySpan		
Louisville Gas and Electric Co.		
Nashville Gas Co.	X	
National Fuel Gas Distribution Corp.		
New England LDCs		X
New Jersey Natural Gas Co.		X
New York State Electric and Gas Corp.		
Northeast Energy Associates and North Jersey Energy Associates		
Process Gas Consumers Group		
ProLiance Energy, LLC		
PSEG Energy Resources and Trade LLC	X	X
Rhode Island State Energy Statutory Trust 2000	X	X
Shell Offshore, Inc.		
United Cities Gas Co., Div. Of Atmos Energy Co.		
Western Kentucky Co., Div. Of Atmos Energy Co.		