UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

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| Southern Natural Gas Company | Docket Nos. | RP00-476-003 |
| | | RP00-476-001 |
| | | RP00-476-004 |
| | | RP01-64-001 |

ORDER ON REHEARING AND COMPLIANCE

(Issued July 30, 2003)

1. On May 13, 2002, several parties requested rehearing of the Commission's April 11, 2002 order in the captioned docket.[1] The Commission's April 11, 2002 order approved, as modified, a contested settlement addressing Order Nos. 637[2] and 587[3] issues

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[1]Southern Natural Gas Co., 99 FERC ¶ 61,042 (2002). The parties requesting rehearing are: Southern Natural Gas Company (Southern); The Alabama Distributors Group, The Austell Gas System, The Southeast Alabama Gas District, and the Municipal Gas Authority of Georgia (Municipals); The Georgia Industrial Group (GIG); Atlanta Gas Light Company and Chattanooga Gas Company (Atlanta), and; Alabama Gas Corporation (Alabama Gas).

[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 (Feb. 9, 2000); <u>order</u> <u>on</u> <u>rehearing</u>, Order No. 637-A, FERC Stats. & Regs., Regulations Preambles (July 1996 - December 2000) ¶ 31,099 (May 19, 2000); <u>order</u> <u>on</u> <u>rehearing</u>, Order No. 637-B, 92 FERC ¶ 61,062 (July 26, 2000); <u>aff'd</u> <u>in</u> <u>part</u> <u>and</u> <u>remanded</u> <u>in</u> <u>part</u>, Interstate Natural Gas Association of America v. FERC, 285 F.3d 18 (D.C. Cir. Apr. 5, 2002), <u>order</u> <u>on</u> <u>remand</u>, 101 FERC ¶ 61,127 (2002).

[3]Standards for Business Practices of Interstate Natural Gas Pipelines, Order No. 587-G, FERC Stats. & Regs., Regulations Preambles (July 1996-December 2000) ¶ 31,062 at 30,677-80 (1998), <u>reh'g</u>, Order No. 587-I, FERC Stats. & Regs., Regulations Preambles (July 1996-December 2000) ¶ 31,067 at 30,735-37 (1998), Order No. 587-K, 64 FR 17276 (Apr. 9, 1999), FERC Stats. & Regs. Regulations Preambles (July 1996-
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filed by Southern Natural Gas Company (Southern). As discussed below, the Commission will grant the requested rehearings in part. In addition, on May 13, 2002 Southern filed tariff sheets to comply with Order Nos. 637 and 587. The Commission will accept Southern's filing to be effective September 1, 2003, as modified below.[4] This order benefits the public by permitting Southern to implement policies described in Order No. 637 which was designed to enhance competition in the natural gas industry.

**BACKGROUND**

2. On July 2, 2001, Southern filed in Docket No. RP00-476-002, a contested settlement addressing its Order No. 637 proceeding. In Order No. 637, the Commission revised, among other things, its regulations relating to scheduling procedures, capacity segmentation, and pipeline penalties in order to improve the competitiveness and efficiency of the interstate pipeline grid. In its April 11, 2002 order, the Commission found that Southern's settlement generally complied with the requirements of Order No. 637, and approved the Settlement subject to certain modifications. The Commission's modifications to Southern's proposal included changes to, inter alia, its segmentation proposal, its scheduling equality and discount proposals, and its secondary point allocation proposal. The Commission also modified Southern's settlement proposal by finding that Southern's proposed changes to its cashout mechanism were beyond the scope of Order No. 637, and not required in order for Southern to conform its tariff to Order No. 637. Southern was ordered to remove this aspect of its proposal.

3. Subsequent to the Commission's approval of Southern's settlement, as modified, several parties, including Southern[5] informed the Commission that the settlement was null and void and that they were not bound by its terms because the settlement had been

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[3](...continued)
December 2000) ¶ 31,072, Order No. 587-L, FERC Stats. & Regs., Regulations Preambles (July 1996-December 2000) ¶ 31,100 (2000), Order No. 587-M, FERC Stats. & Regs., Regulations Preambles (July 1996 - December 2000) ¶ 31,114 , 98 FERC ¶ 61,257 (2002) (Order No. 587-N).

[4]Southern states that it files these tariff sheets consistent with the April 11, 2002 order pursuant to its general obligation to comply with the directives of Order No. 637, even though the Settlement approved as modified by the April 11, 2002 order, no longer has any force or effect. Southern Transmittal Letter at 2.

[5]Parties filing such notices with the Commission included Southern, Mississippi Valley Gas Company (Mississippi Valley), Atlanta Gas, and the Municipals.

modified in a manner such parties deemed unacceptable pursuant to Section 9.2 of the settlement.[6] In notifying the Commission of its intent to invoke Section 9.2 of the settlement, Southern identified the Commission's rejection of its cashout proposal and modification of its segmentation proposals as modifications which would have a material adverse effect on it. The other parties invoking Section 9.2 of the settlement, to the extent reasons were given, focused primarily on the Commission's rejection of the cashout proposal as the reason for their withdrawal from the settlement.

4. The instant order will address the requests for rehearing of the Commission's April 11, 2002 order approving Southern's settlement as modified, as well as Southern's May 13, 2002 filing to comply with Order Nos. 637, 587, and the dictates of the April 11, 2002 order. Given the fact that the parties have invoked terms of the Settlement rendering it null and void, the Settlement itself no longer has force and effect. However, the Commission will address the requests for rehearing on various aspects of its April 11, 2002 order approving the Settlement to the extent that they raise issues of continuing relevance in determining on the merits whether Southern has complied with Order Nos. 637 and 587.

**DISCUSSION**

**I. Rehearing Requests**

5. For the reasons discussed below, the Commission generally denies rehearing of the April 11, 2002 order, but does grant rehearing in part on one issue.[7]

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[6]Section 9.2 of the Settlement states that:

> If the Settlement is approved with condition or modification with respect to all parties in this proceeding, the Settlement shall be null and void and shall not become effective in the event Southern or one or more of the parties listed on Appendix A notifies the other parties by filing notice with the Commission in writing within fifteen (15) days, . . . of the date of the Commission Order approving the Settlement with the condition or modification that (I) the condition or modification has a material adverse effect on it and (ii) it is unwilling to accept the Settlement as modified.

[7]The Municipals state that the settlement at this point is null and void and cannot

(continued...)

### A. SEGMENTATION

#### 1. Commission Requirement

6. Under its proposed settlement, Southern proposed to permit segmentation within a zone, provided that the capacity to be segmented is outside a reticulated area on Southern's system and Southern can reasonably determine the capacity to be segmented. Southern stated that the reticulated areas are limited to the areas on Southern's system where Southern must direct gas in alternate directions during the course of the day in order to provide service under Rate Schedules FT, FT-NN, and CSS.[8]

7. The April 11, 2002 order considered Southern's claims that parts of it system are reticulated based upon the assertion that gas flow can be reversed. Southern asserted that these portions of its system cannot be segmented and, as a result, it did not propose to allow segmentation on these areas of its system. The Commission found that, Southern's system did not contain the multi-direction gas flow and displacement features to the extent usually associated with a reticulated pipeline and that in the Commission's view, segmentation of the entire system was not infeasible simply because gas flow may be reversed from time to time on parts of the system. The Commission determined that consistent with the Commission's decision in CIG,[9] Southern would be required to modify its settlement proposal to state that it will accept and evaluate segmentation requests in those areas where gas flow may be reversed, to specifically delineate the bounds of those areas, and to provide service to the extent operationally feasible.

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[7](...continued)
take effect. Southern states that it does not seek rehearing to resurrect the settlement but seeks rehearing of the Commission's merits determinations based upon the record in its Order No. 637 proceeding.

[8]Article V of the Settlement defined the areas of Southern's system it considered to be reticulated as areas in which "during the course of any gas day, Southern must be able to change the direction of flow in order to provide service under its Rate Schedules FT, CSS and FT-NN." Southern also provided a map that reflected such areas as a segment on Southern's northern system extending from Louisiana into Mississippi, a segment joining the northern and southern systems, and a segment on the eastern end of the northern system in Georgia.

[9]95 FERC ¶ 61,321 at 62,115-117 (2001).

### 2. Requests for Rehearing

8. On rehearing, Southern contends that the April 11, 2002 order erred in determining that Southern was required to permit segmentation in narrowly defined reticulated portions of Southern's system without regard to the record established in this proceeding which supported the proposed limitation of segmentation in such reticulated areas.

9. Specifically, Southern argues that its definition of reticulation was not, as the Commission suggests, areas of the system where gas flow may be reversed from time to time, but rather, areas in which during the course of any gas day, Southern must be able to change the direction of flow in order to provide service under its Rate Schedules FT, CSS and FT-NN. Southern argues that its definition does not merely reflect the possibility of a reversal of gas flow. Rather, it weighs such a possibility, assigns it a timeframe, and specifies an operational reason for the reversal of flow. Southern argues that its definition of a reticulated area was a logical balance between parties that wanted unrestricted intrazone segmentation and those that were concerned regarding the reliability of their firm services. Southern argues that instead of accepting the experience of the parties on Southern's system regarding the possibilities of segmentation, the Commission determined that segmenting was feasible on these limited, reticulated areas of Southern's system.

10. Southern argues that the Commission's requirement that Southern apply criteria on a daily basis to determine whether segmenting in the reticulated areas was feasible misses the mark because this requirement ignores the critical link between Southern's definition of reticulation and the operational requirements of FT-NN service. Southern asserts that FT-NN service is a no-notice service and, therefore, Southern receives no notice or nomination that a customer requires such service but is required by contract to provide the service. Southern argues that it does not know in advance how or when it will have to direct gas flows in the reticulated areas to provide FT-NN service and therefore, it cannot evaluate segmented nominations within the reticulated areas at each of the four nomination cycles in order to allow segmentation to the extent operational feasible as required by the Commission.

11. Southern argues that the proposal addressed by the April 11, 2002 order is an entirely reasonable and tightly crafted unprotested mechanism which allows for the operational difficulties of reversing gas flow in order to meet the requirements of providing FT-NN service. Southern argues that in rejecting Southern's claim that segmentation on the reticulated parts of Southern's system is operationally infeasible the Commission ignores precedent in both Gulf South and East Tennessee where the Commission determined that the limitation of segmentation in designated geographical

areas was appropriate.[10] Southern points out that in East Tennessee the Commission approved a settlement on a system similar to Southern's in which segmentation was permitted on less than 25 percent of the pipeline's system. Southern asserts its segmentation proposal accomplishes more of the goals of Order No. 637 than the proposal accepted by the Commission in Gulf South, even though the defined reticulated areas on Southern's system follow the operational characteristics of those portions of Gulf South which have been found to be reticulated.

12. The Municipals argue that in offering interzonal segmentation as a part of its settlement, Southern recognized that such segmentation would degrade the firm service that it offers its customers. The Municipals argue that they would have opposed such a proposal if it had not been part of a settlement. They argue that now that the settlement is null and void, they strongly oppose Southern's proposal for increased segmentation particularly inasmuch as no party to this proceeding has shown that such segmentation is operationally feasible. In addition, the Municipals argue that in imposing the requirement that Southern offer segmentation in areas of its system where gas flow may be reversed the Commission has not met its burden to show that this additional requirement would be operationally feasible.

### 3. Commission Ruling on Rehearing Requests

13. The Commission adopted segmentation as a policy in Order No. 636 in order to enhance the value of firm transportation to shippers and to permit capacity release to compete more effectively with the pipeline's capacity. In Order No. 637, the Commission found pipelines had not consistently implemented the policy and promulgated a rule requiring pipelines to permit segmentation to the extent operationally feasible.[11] In Order No. 637, the Commission made a generic finding that the failure to permit segmentation where operationally feasible is unjust and unreasonable because it restricts efficient use of capacity without adequate justification.[12] It stated that it would determine whether any particular pipeline's tariff is unjust and unreasonable in the individual pipeline's

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[10]Southern Rehearing Request at 15-16, citing, Gulf South Pipeline Co., LP., 98 FERC ¶ 61,278 (2002) and East Tennessee Natural Gas Co., 98 FERC ¶ 61,278 (2002).

[11]Order No. 637 at 31,301-04; 18 C.F.R. § 284.7(d) (2003).

[12]Order No. 637 at 31,303-04; Order No. 637-A at 31,590-91; INGAA, 285 F.3d 18, 37-38 (D.C. Cir. 2002).

compliance proceeding. In INGAA,[13] the D.C. Circuit affirmed Order No. 637's requirement that pipelines permit segmentation where operationally feasible, upholding the Commission's finding that such a requirement is "necessary for reasonable pursuit of the Commission's policy of enhancing competition by increasing the flexibility of capacity releases."[14]

14. There can be no question that Southern's failure to adopt segmentation to the extent it is operationally feasible is unjust and unreasonable. Not permitting operationally feasible segmentation inhibits the efficient use of capacity, denies shippers the same flexibility that pipelines had prior to Order No. 636, prevents competition, and inhibits the formation of market centers. Also, allowing shippers currently on the pipeline the option to release different segments of capacity increases competition in the sale of pipeline capacity by giving purchasers of capacity greater options for obtaining the capacity they need.

15. The key issue in acting under NGA Section 5 to require Southern to permit segmentation in the reticulated areas of its system boils down to whether the required segmentation is operationally feasible. Southern continues to argue in its rehearing request that it cannot evaluate segmentation requests in these areas because it must meet the demands of no-notice service which will not become evident in time to evaluate requests for segmentation. Southern has, however, proposed an operationally feasible segmentation proposal in its May 13 Compliance Filing, which the Commission approves below. That proposal contains twelve criteria Southern may use to evaluate whether a segmented transaction can be scheduled. These criteria include the projected requirements of its no-notice shippers and historical flow patterns in the affected areas. Given Southern's experience in operating its system to meet the needs of its customers, Southern's use of its proposed criteria should enable it to allow segmentation on the reticulated parts of its system without adversely affecting service to no-notice shippers.

16. As the Court recognized in INGAA, the purpose of the Commission's segmentation policies established in Order Nos. 636 and 637 is to promote competition in the secondary market between firm shippers releasing capacity and pipelines as well as between releasing shippers themselves. As the Commission recognized in the April 11, 2002 order, while a pipeline may not be able to offer full segmentation in reticulated

[13] INGAA, 285 F.3d 18 at 36-38 (D.C. Cir. 2002).

[14] Id. at 38.

areas, that does not mean it should be permitted to completely deny segmentation opportunities in such areas.

17. Moreover, contrary to Southern's assertion, our requirement that Southern permit segmentation in the reticulated areas when operationally feasible is not inconsistent with our orders in Gulf South and in East Tennessee. Unlike Southern's system, Gulf South's entire system is reticulated, and there we adopted a virtual point segmentation proposal that covered Gulf South's entire system. In East Tennessee, we exempted part of the system from any segmentation requirement because there were not any interconnections there that allowed for segmentation, not because the system was reticulated. In addition, we required East Tennessee to file a segmentation plan for this part of its system when segmentation becomes operationally feasible through expansion projects.

18. Finally, the Commission finds that, as discussed further in the compliance section of this order, the concerns of the Municipals regarding possible degradation of existing firm services are adequately addressed by the conditions Southern has placed on its segmentation proposal.

## B. CREDITING REVENUE MECHANISM

### 1. Commission Requirement

19. In its April 11, 2002 order, the Commission determined that while Southern's scheduling and imbalance penalties were appropriate, Southern had not provided for crediting of these penalty revenues as required by the regulations and directed Southern to revise its tariff so that all penalty revenues (net of costs) will be refunded to non-offending shippers.

### 2. Request for Rehearing and Commission Ruling

20. Southern requests that the Commission clarify that Southern's existing tariff provision in Section 14.2 of its General Terms and Conditions (GT&C) constitutes an acceptable penalty crediting mechanism consistent with Order No. 637. In the alternative, Southern requests rehearing of the Commission's determination on this issue. The Commission clarifies that Southern's tariff provides an acceptable penalty revenue crediting mechanism and that no further action need be taken on this issue for Southern to comply with the dictates of Order No. 637.

### C. DISCOUNTING

#### 1. Commission Requirement

21. The April 11, 2002 order directed Southern to file tariff sheets to implement the Commission's policy as adopted in CIG/Granite State,[15] where the Commission found that a shipper may retain a discount when it moves to segmented points or secondary points through a streamlined request process.

22. As stated in the April 11, 2003 order, the Commission reasoned that its discount and segmentation policies could best be balanced by adoption of a policy under which a shipper with a discounted rate that seeks to use an alternate receipt or delivery point (whether through segmentation, capacity release, or its own exercise of flexible receipt and delivery point rights) can continue to receive a discounted rate if the pipeline has granted a discount to a similarly situated transaction at the alternate point.[16] The Commission stated in CIG that "this policy is an application of the general requirement that pipelines must not engage in undue discrimination."[17] By ensuring that a shipper with a discounted contract can continue to receive a discount at points where it is similarly situated to other shippers receiving a discount, this policy allows a shipper to better compete with the primary capacity offered by the pipeline and with other shippers holding contracts for capacity at these points.

23. In its April 11, 2003 order the Commission explained that under this 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

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[15] 99 FERC at 61,161, citing, Colorado Interstate Gas Co., 95 FERC ¶ 61,321 (2001); Granite State Gas Transmission, Inc., 96 FERC ¶ 61,273 (2001), order on reh'g, 98 FERC ¶ 61,019 (2002).

[16] 99 FERC at 61,160, citing, Paiute Pipeline Co., 96 FERC ¶ 61,167, at 61,750 (2001) (explaining that the CIG discount policy applies to the use of secondary points whether through capacity release transactions, segmentation, or the use of flexible receipt or delivery points).

[17] 95 FERC ¶ 61,321, at 62,121.

discounts for its firm or interruptible transportation services.[18] The pipeline can rebut this presumption by demonstrating that the segmented or secondary point transaction is not similarly situated to the transactions receiving the discount at the secondary point. The Commission placed the burden on the pipeline to justify a denial of a discount, because the Commission was concerned that pipelines may not have the same incentive to offer discounts to segmented transactions or to secondary points that compete directly with their sale of primary capacity.

### 2. Request for Rehearing

24. On rehearing, the Municipals argue that the requirements imposed by the Commission under its selective discounting policies which require that the pipeline must justify its discounts because of the Commission's concerns that selective discounting has the potential for giving rise to undue discrimination.[19] They argue that, while it continues to oppose the Commission's selective discounting policy, the selective discounting policy requires some justification by the pipeline. It argues that the requirement imposed in the instant case, adopts a policy that would allow a pipeline to grant any and all discounts without any justification. The Municipals assert that these discounts presumably would automatically qualify for discount adjustments in later rate cases on the theory that they were mandated by Commission policy.

### 3. Commission Ruling on Rehearing Request

25. The Commission also denies this request for rehearing. The basic purpose of the CIG/Granite State discount policy is to enhance competition by making it easier for firm shippers to compete with the pipeline. There has been no showing that this policy will have any significant adverse effect on maximum rate shippers through an increase in the discount adjustment in the next rate case. Under the CIG/Granite State policy, the Commission chose a balanced approach under which shippers only get to keep discounts at alternate points if competition requires the discounts at that point. Thus, in CIG, the Commission did not allow a shipper to retain its discount when it utilizes secondary points when competition does not require discounts to similarly situated shippers. The

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[18]The shipper seeking to move its point will pay the higher of its contractual rate or the discount rate being offered at the alternate point. See CIG, 95 FERC ¶ 61,321, at 62,121 n.38 (2001).

[19]Municipal's Request for Rehearing at 16, citing, Policy Statement Providing Guidance with Respect to the Designing of Rates, 47 FERC ¶ 61,122 (1989).

Commission determined that this could have negative consequences, including exacerbating the impact of a rate case adjustment in future rate cases. Where the shipper does retain its discount the revenue the pipeline receives from the flexed contract remains, at worst, unchanged at the discounted level it already receives, since, as discussed above, the policy does not require the pipeline to reduce the rate below the contract rate. If the shipper were not able to retain its discount when using a different point, it might well not use the different point, so that the pipeline would not earn additional revenue in any event. The Commission concludes that the effect of the CIG/Granite State policy on discount adjustments in future rate cases is speculative. However, we note that in any future rate case, the pipeline must meet the burden of justifying its discounts. On balance, the Commission finds that the CIG/Granite State policy is necessary to help competition and avoid discrimination. Any speculative effects on future rate cases is not sufficient reason to reverse the CIG/Granite State policy here.

### D. Cashout Mechanism

#### 1. Commission Requirement

26. Under Southern's current tariff provisions, the price payable to Southern by shippers whose monthly delivery quantities exceed monthly receipt quantities (and conversely payable to shippers by Southern when the reverse occurs) is fixed according to a tiered pricing formula based on a monthly index price. The April 11, 2002 order addressed Southern's proposal to make several changes to the price at which imbalances would be cashed out.[20]

27. The April 11, 2002 order determined that Southern's proposal to modify its cashout mechanism was beyond the scope of Order No. 637, that it was not required in order for

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[20] The existing index price is the average price of several published spot prices. Southern proposed to add to the calculation of the index price, the Natural Gas Intelligence end of month price for "Louisiana-Southern Natural Gas Spot Average." For resolution of majority imbalances in the greater than 2 percent to 5 percent tier, the index price will be the highest or lowest of the prices for each week or the monthly price, including the end of month price, depending on whether a shipper is long or short respectively. For resolution of majority imbalances above 5 percent, Southern proposed that existing pricing tiers in the tariff be retained, with the cashout price based on the high-low price used in the 2-5 percent tier. Southern proposed to use the existing index price without the addition of the end of month price to resolve minority imbalances, and also proposed to eliminate tiering for resolving minority imbalances.

Southern to conform its tariff to Order No. 637, and directed Southern to file tariff sheets to remove this aspect of its proposal. On rehearing, Alabama Gas, Atlanta, Municipals and Southern argue that the Commission erred in finding that Southern's cashout proposal was beyond the scope of Order No. 637.

### 2. Request for Rehearing

28. Alabama Gas argues that the Commission erred in finding that Southern's proposal was beyond the scope of Order No. 637. It argues that Order No. 637 ordered pipelines to recraft their current broad penalty provisions in ways that directly focus on harm to the pipeline's system and do not encourage the use of penalties as a substitute for obtaining services. Alabama Gas states that Order No. 637 cited, as an example, that pipelines may be able to change the methods by which they cashout imbalances to eliminate the incentives for shippers to borrow gas from the pipeline.[21] Moreover, it asserts that Order No. 637-A continued to stress that pipelines may be able to change their imbalance cashout procedures or methods to eliminate the incentives for shippers to borrow gas from the pipeline because the cashout price for the gas is less than the market price of the gas.[22]

29. The Municipals argue that the proposed revisions are not penalties nor penalty increases and therefore, the Commission has erred in rejecting the proposal as a penalty increase not authorized by Order No. 637. The Municipals argue that the proposed revisions are cost-based measures and consistently result in a more accurate proxy for the costs of a shipper to be in balance. The Municipals argue that Order No. 637-A was clear that a penalty must consist of more than the costs incurred as a result of the correction of imbalances.[23] Alabama Gas argues that a penalty is "a charge imposed by the pipeline on a shipper that is designed to deter shippers for engaging in certain conduct and reflects more than simply the costs incurred as a result of the conduct. . . . [A] cashout mechanism that only requires the shipper to reimburse for the cost of gas provided by the pipeline is not a penalty."[24] Therefore, the parties argue that the settlement proposal did not attempt to increase penalties.

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[21] Alabama Gas Rehearing Request at 5, citing, Order No. 637 at pp. 31,314-15.

[22] Alabama Gas Rehearing Request at 6, citing, Order No. 637-A at p. 31,610.

[23] Municipals Rehearing Request at 7, citing, 637-A at 31,610.

[24] Alabama Gas Rehearing Request at 6, citing, Order No. 637-A at p. 31,607.

30. The parties on rehearing also argue that the Commission's action is inconsistent with the Commission's orders on various other pipelines' Order No. 637 compliance filings. First, they contend that the proposed revisions are essentially the same as those accepted in Transcontinental Gas Pipe Line Company, 96 FERC 61,352 (2001), where the Commission addressed a cashout mechanism filed by Transco in an order that addressed both an Order No. 637 compliance filing and a Natural Gas Act (NGA) Section 4 filing (the 1Line filing). Southern asserts that the Commission had an opportunity to place its discussion of the cashout issue in the NGA Section 4 category designated as the "1Line filing issues" if these issues were beyond the scope of Order No. 637; however, the Commission did not do so and instead ruled on the cashout issue as a part of the Order No. 637 compliance filing.[25]

31. The parties also assert that the Commission also accepted a similar provision in Gulf South Pipeline Company, 97 FERC ¶ 61,069 (2001) in order to effectuate the policy underlying Order No. 637 of discouraging gaming. In addition, the Municipals argues that in Reliant Energy Gas Transmission Company, 98 FERC ¶ 61,362 (2002), the Commission accepted a cashout modification that had been included as a part of a settlement over objections that the proposal was contrary to Order No. 637 in that it eliminated the first tier "penalty-free" imbalance zone. The Municipals argue that the Commission found that the proposal did not modify the existing penalty free tolerance range for imbalances since it included pricing for that range which was cost-based.[26] The Municipals assert that the same situation is applicable in the instant case where the pricing for Tier 1 imbalances has been placed on a cost basis. Therefore, the Municipals assert that both Transco and Reliant require that the Commission approve the cashout

[25]The Commission notes that its September 27, 2001 order also specifically stated:

> The Commission will first turn to issues raised by Transco's filing to comply with Order No. 637, then issues related to its filing to implement its 1Line system and finally to issues concerning its compliance with the dictates of Order Nos. 587-G and 587-L, although in some instances an issue will be discussed with like issues without regard to the type of filing under which it was originally submitted by Transco. 96 FERC ¶ 61, 352 at 62,307 (2001) (emphasis added).

[26]Rehearing Request of the Municipals at 11, citing, 98 FERC at 62,551.

provisions proffered by Southern.[27] Alabama Gas asserts that in Questar Pipeline Company, 98 FERC ¶ 61,159 (2002) the Commission also approved a pipeline's proposal to replace its current monthly imbalance penalties with a monthly cashout provision with cashout tiers based upon the size of the imbalance, stating that it has consistently approved tiered cashout mechanisms.

32. On rehearing, parties also assert that the Commission specifically placed concerns related to Southern's cashout mechanism and arbitrage in Southern's Order No. 637 proceeding. They contend that in two previous Southern annual storage cost reconciliation mechanism (SCRM) proceedings, the Commission stated that the appropriate forum for discussion of the imbalance cashout issues was in Southern's Order No. 637 proceeding.[28] They argue that this determination led the parties to address the issue in settlement negotiations in Southern's Order No. 637 settlement proceeding. For example, Alabama Gas argues that the Commission's decision leaves it without a forum to address its contentions that the existing mechanism is unjust and unreasonable because it creates incentives for arbitrage.

### 3. Commission Ruling on Rehearing Requests

33. The Commission denies rehearing on this issue. In Texas Eastern Transmission, LP, 102 FERC ¶ 61,198 (2003) (Texas Eastern), the Commission considered a similar circumstance in rejecting Texas Eastern's proposal to modify its cashout mechanism in its Order No. 637 proceeding. In Texas Eastern, the Commission considered the scope of Order No. 637 in regard to the modification of a cashout mechanism in order to minimize arbitrage and stated that:

> Although Order No. 637 articulated a number of policies and goals with respect to imbalance management services, penalties, cash-out mechanisms, and arbitrage, not all of those policies required pipelines to make revisions to their tariffs.

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[27] Atlanta Gas also argues that the Commission precedent, as cited by Municipals, demonstrates that there is no reasoned basis for the Commission to have rejected Southern's cashout proposal in the instant proceeding when it considered and accepted changes to pipeline cashout mechanisms in other Order No. 637 proceedings. Rehearing Request of Atlanta at 4-5.

[28] Citing, 98 FERC ¶ 61,126 (2002); 93 FERC ¶ 61,235 (2000), order on reh'g, 94 FERC ¶ 61,197 (2001)

> Order No. 637 did not require pipelines to make any changes to their cash-out mechanisms, nor did it require pipelines to propose changes to their system management programs to reduce or otherwise address problems of arbitrage. While the Commission in the preamble of Order No. 637 emphasized that discouraging or reducing the possibility of arbitrage was one of its goals, and stated, as Texas Eastern points out, that "pipelines may be able to change the methods by which they cash-out imbalances to eliminate the incentives for shippers" to game the system, this statement did not require pipelines to make penalty structures more stringent. The Commission was specifically looking for solutions to address this matter that did not involve a tightening of cash-out provisions and penalties. Indeed, the Commission in Order Nos. 637 and 637-A specifically criticized the pipelines' typical response of escalating tolerances and imbalances as a response to arbitrage. 102 FERC at P 101.

34. The Texas Eastern order concluded that the "only action pipelines were required to take with respect to their penalty provisions in order to comply with Order No. 637 was to justify that their existing penalties were no more restrictive than necessary under Section 284.12 (c)(2)(v)." Id at P 12. Therefore, Order No. 637 did not require Southern to modify its cashout mechanism to minimize arbitrage as part of its Order No. 637 compliance filing. In addition, Southern's proposal does make its cashout penalty structure more stringent by replacing its current use of monthly average weekly prices with a price structure based upon highest or lowest weekly prices. The highest weekly price will be higher than average prices for the month and the lowest weekly price will be lower that the average prices for the month. Since penalty tiers of Southern's cashout mechanism are based on percentages of these high/low prices, the penalties incurred under the revised cashout mechanism would be higher than under the existing cashout mechanism.[29]

35. Moreover, Texas Eastern considered the application of several cases cited by the parties in the instant case as precedent for the approval of Southern's cashout mechanism modification in its Order No. 637 compliance proceeding. In Texas Eastern, the Commission found that Transco; Gulf South and Texas Gas Transmission Corporation, 96 FERC ¶ 61,318, order on reh'g, 97 FERC ¶ 61,349 (2001) (Texas Gas) were:

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[29] See Texas Gas Transmission Corp., 97 FERC ¶ 61,349 at 62,633 (2002).

> separate NGA Section 4 proceedings, not compliance filings to implement the requirements of Order No. 637. In those cases pipelines proposed changes to their cash-out mechanisms in Section 4 filings, which the Commission then evaluated under the policies of Order No. 637. The various statements by the Commission in those cases, which Texas Eastern cites, to the effect that changes to a pipeline's cashout mechanism to remove the incentive for arbitrage "are appropriate under Order No. 637" were meant to reflect that such changes are consistent with the policies of Order No. 637, not that such proposed tariff changes are appropriately made in, or within the scope of, Order No. 637 compliance filings. 102 FERC at P 102.

36. The parties have also argued that cases such as Questar and Reliant require the Commission to modify its findings on rehearing.

37. In Questar, the Commission was presented with a situation where the pipeline proposed to institute a cashout mechanism in place of its existing imbalance penalties. The Commission found that since the cashout mechanism involved an increase in punitive costs over the existing imbalance penalty structure, Questar must modify the cashout component responsible for the increase.[30] Subsequently, in evaluating Questar's compliance filing, the Commission found that Questar had proposed penalties higher than the $1.00 penalty it proposed in its original filing and higher than the penalty levels under its existing imbalance penalty provision. The Commission stated that Order No. 637 was not an opportunity for pipelines to file to increase penalties or make their penalty provisions more stringent and directed Questar to file a revised tiered-penalty structure that will not impose greater penalties on imbalances within certain tolerance than the

[30] Specifically, the Commission found that Questar's proposal to increase the penalty from $0.50 to $1.00 per Dth for imbalances in the 5 percent to 7 percent tier and eliminate the tiered penalty structure was inconsistent with Commission precedent. 98 FERC at 61,584.

penalty levels under its existing imbalance penalty provision.[31] Therefore, the findings in Questar support the Commission's action in the instant proceeding.

38. In Reliant, the pipeline filed a settlement to resolve all issues related to its Order No. 637 compliance filing and to modify its cashout mechanism as was attempted in the instant proceeding. There, the Commission determined that the proposed cashout modifications allowed a direct relationship between the imbalances and the prices used to cash out that imbalance and that it removed the arbitrariness of the high/low cashout system in contrast with Southern's proposal which would institute a high/low cashout system.[32] The Commission also recognized that the pipeline's proposed modifications were not objected to by the shippers.[33] In view of these factors, the Commission found that the modification yielded a mechanism that was not punitive. The Commission was, therefore, presented with an uncontested proposal that was not punitive and that benefitted the shippers by linking the costs of imbalances with the costs of resolving the imbalances. Accordingly, the Commission accepted the mechanism and no party objected to the Commission's decision on rehearing. This finding was consistent with our holdings concerning the scope of the changes pipelines are required to make in their Order No. 637 compliance proceedings in that the shippers benefitted from a mechanism that more appropriately linked costs of imbalances and costs incurred to resolve such imbalances.

39. In the instant proceeding, Southern's cashout mechanism was protested by numerous parties for a variety of issues including (1) that such revisions were prohibited under the terms of the rate case settlement currently in effect in Docket No. RP99-496; (2) that the proposed modifications yield a more punitive cashout mechanism than the

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[31] 100 FERC ¶ 61,212 P 72 (2002). On May 9, 2003, the Commission accepted a compliance filing by Questar wherein Questar proposed a revised tiered penalty structure designed not to exceed the existing imbalance penalties found in its tariff. 103 FERC ¶ 61,157 (2003).

[32] In Reliant, the pipeline proposed a mechanism whereby the gas prices in effect on the day that a shipper was out of balance in the same direction as the shipper's end of month net imbalance are utilized. 98 FERC at 62,550-51.

[33] The Commission notes that Indicated Shippers raised a concern related to Reliant's proposed modification of its cashout mechanism and argued that the proposed modification would in effect eliminate a penalty tier. The Commission found however, that Indicated Shippers was mistaken in its argument and that, in fact, Reliant's proposed modification did not eliminate an existing penalty tier. 98 FERC at 62,550-51. The Indicated Shippers did not raise this issue on rehearing.

existing Southern cashout mechanism and were therefore inconsistent with Order No. 637; and (3) that Southern had not proven that increased costs under its Storage Cost Reconciliation Mechanism (SCRM) and passed on to all customers, were due to shipper arbitrage that Southern claimed to have attempted to mitigate under its proposed modifications to its cashout mechanism.

40. Therefore, in the instant proceeding, in contrast to the Reliant proceeding, the Commission was presented with a proposal to change a cashout mechanism that was not required by Order No. 637, that was protested by a variety of shippers and did not result in the same direct relationship between the imbalance costs and the cost of resolving such imbalances that would allow the Commission to readily determine that the proposed mechanism was not punitive and would benefit the shippers.[34] Accordingly, the Commission rejected Southern's proposed mechanism finding that it was beyond the scope of the changes required in order to comply with Order No. 637. The Commission made no determination regarding the relative merits of Southern's proposal and stated that Southern was free to make a similar proposal under NGA Section 4.

41. The parties have also argued that the Commission directed them in several SCRM proceedings to raise concerns with Southern's cashout mechanism in Southern's Order No. 637 proceeding. The parties are correct in that the Commission initially determined that such concerns would be investigated in Southern's Order No. 637 proceeding. However, in Docket No. RP03-123-000, in a proceeding addressing Southern's latest SCRM

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[34] Southern's proposal does not employ the same direct link to prices as that proposed in Reliant, where prices in effect on the day the shipper was in an imbalance posture are utilized. Under Southern's tiered cashout system, the price payable to Southern by shippers whose monthly delivery quantities exceed monthly receipt quantities (and conversely payable to shippers by Southern when the reverse occurs) is fixed according to a tiered pricing formula based on a monthly index price which is derived from the average price of certain spot prices published by "Natural Gas Intelligence" and "Inside F.E.R.C." Southern proposed to change the price at which imbalances would be cashed out by adding to the calculation of the index price, the Natural Gas Intelligence end of month price for "Louisiana-Southern Natural Gas Spot Average." For resolution of majority imbalances in the greater than 2 percent to 5 percent tier, the index price is proposed to be the highest or lowest of the prices for each week or the monthly price, including the end of month price, depending on whether a shipper is long or short respectively. For resolution of majority imbalances above 5 percent, existing pricing tiers in the tariff will be retained, with the cashout price based on the high-low price used in the 2-5 percent tier.

proceeding, the Commission instituted a technical conference proceeding to examine Southern's cashout mechanism, the SCRM mechanism, and the relationship between these mechanisms.[35] Therefore, a forum has been presented for the parties and the Commission to fully investigate the issues raised by these mechanisms on Southern's system. On April 9, 2003 a technical conference was held to discuss these issues and the parties were given an opportunity to fully brief their concerns.

42. Accordingly, the Commission denies the requests for rehearing on this issue.

## E. OPERATIONAL FLOW ORDERS (OFOs)

### 1. Commission Requirement

43. The April 11, 2002 order found that Southern's OFO provisions generally comply with the requirements of Order No. 637 to minimize the use and adverse impact of OFOs. The order also found that Southern's proposal to divide its Type 3 OFO into three levels was not unusually complex, as asserted by GIG, but that it appeared to be merely an attempt to tailor the OFO level to the type of conditions faced by the pipeline according to the dictates of Order No. 637.

### 2. Request for Rehearing

44. The Municipals argue that the April 11, 2002 order accepted a proposed increase in penalties for Level 3, Type 3 OFOs on Southern's system after stating that it was inappropriate to consider the proposed revision to Southern's cashout mechanism on the basis that it constituted a penalty increase and was therefore inappropriate for consideration in an Order No. 637 compliance proceeding. The Municipals point out that the original penalty for a Level 3, Type 3 OFO was $15 per dth. They argue that Southern's proposal to change the penalty to the greater of $15 per dth or twice a particular gas index should also be prohibited. GIG argues the Commission erred in permitting Southern to modify its Level 3 OFO mechanism resulting in a more complicated mechanism and to increase certain OFO penalties. GIG states that the Commission failed to determine whether Southern's graduated structure of OFOs will reduce the negative impact of OFOs on Southern's system and that the Commission failed to determine that the penalty associated with each grade of OFO is operationally justified. GIG states that in all likelihood Southern's proposed change will lead to more shipper

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[35] Southern Natural Gas Co. 101 FERC ¶ 61,397 (2003).

confusion and, consequently more mistakes, thus increasing the negative effects of the OFOs on Southern's system.

### 3. Commission Ruling on Rehearing Request

45. The Commission will grant rehearing, in part, on this issue. The Commission finds that Southern's proposed three part Type 3 OFO allows the pipeline a greater range of tools to keep its OFOs closely proportional with any operational problem. The addition of these graduated levels of OFOs is beneficial to customers in that additional levels of OFOs reduce the possibility that the strictest level of OFO will be necessary to maintain operational integrity.

46. However, the Commission finds that modification is necessary to Southern's proposed OFO penalties. Southern's proposed penalties for Level 1 and Level 2 of the Type 3 OFO represent penalties that were, respectively, lower than ($10 per Dth) and equal to ($15 per Dth) the penalty level of the currently effective Type 3 OFO penalties. Therefore, this aspect of Southern's proposal did not involve an increase in OFO penalties. However, for its Level 3 Type 3 penalty Southern proposed a penalty equal to the greater of $15 per Dth or twice the applicable daily index price established in Gas Daily's "Midpoint Louisiana Onshore South" for any day in which the OFO is in effect. Since the Type 3 OFO penalty is $15 per Dth, this would result in an increased penalty when twice the applicable daily index price is higher than $15. Consistent with the previous discussion that proposals to increase penalty levels are beyond the scope of an Order No. 637 compliance proceeding, the Commission finds that Southern's proposal must be modified so that it does not result in an increase in the existing penalty level for OFO Type 3 Level 3.

## II. May 13, 2002 Compliance Filing

47. On May 13, 2002, Southern filed revised tariff sheets to comply with the dictates of Order Nos. 637 and 587 and the April 11, 2002 order. The tariff sheets filed by Southern in the instant filing reflect the tariff sheets acted upon by the Commission in its April 11, 2002 order and found to be just and reasonable, as well as tariff sheets Southern has modified to comply with the April 11, 2002 order. Except as discussed below, the instant tariff sheets contain the modifications required by the Commission in its April 11, 2002 order in order to ensure full compliance with Order Nos. 637 and 587. Therefore, as modified below, the Commission finds that the tariff sheets filed by Southern in the instant filing comply with Order Nos. 637 and 587 and accepts them to be effective

September 1, 2003.[36] DETM, the Municipals and GIG filed protests to the compliance filing.

### A. Compliance Obligation

48. The April 11, 2002 order approved a contested settlement filed by Southern to satisfy the requirements of Order Nos. 637 and 587, subject to Southern filing actual tariff sheets consistent with the Commission's directives within 30 days of issuance of the order. As discussed above, the Settlement was subsequently rendered null and void by its parties.

#### 1. Comments

49. The Municipals argue that the Commission must reject, pursuant to the Settlement it approved, Southern's compliance filing. They argue that with the termination of the Settlement, there is no substantial evidence for the adoption by the April 1, 2002 order of the substantive provisions set forth in the Settlement, particularly the provisions regarding segmentation and the OFO increased penalties. GIG comments that because Southern has withdrawn from the settlement, thus rendering superfluous the Commission's April 11, 2002 order, GIG is confused by Southern's filing of tariff sheets seeking to implement the findings in the Commission's April 11, 2002 order.

#### 2. Commission Ruling

50. In this proceeding, Southern sought to settle a Commission NGA Section 5 proceeding with its shippers. But Southern did not achieve a complete settlement and many of its proposals were protested. Under its regulations, the Commission was required to determine whether the proposals on contested issues were just and reasonable on the merits in order to approve the settlement.[37] In fact, because this is a proceeding

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[36] Trailblazer Pipeline Co., 85 FERC ¶ 61,345 at 62,339 (1998), citing, Mobile Oil Corp., v. FERC, 417 U.S. 283, 314 (1974); See also, Indicated Shippers v. Sea Robin Pipeline Co., 81 FERC ¶ 61,146 (1997).

[37] 18 CFR § 385.602 (h) (2003) states:

> If the Commission determines that any offer of settlement is contested in whole or in part, by any party, the Commission

(continued...)

initiated by Order No. 637 under the NGA Section 5 in order to improve the competitive structure of the natural gas industry, the Commission reviewed this entire settlement including the uncontested portions, on the merits to determine whether it complied with Order No. 637.

51. Thus, in ruling on Southern's settlement proposal, the Commission determined whether the provisions served the competitive goals of Order 637, and modified those provisions that it found were unjust and unreasonable and conflicted with these competitive requirements, without regard to the fact the filing was styled as a settlement. Thus, the Commission has properly supported its rulings on the merits in this proceeding. Accordingly, it is appropriate to review Southern's May 12, 2003 compliance filing to determine if it complies with the directives of the April 11, 2002 order and satisfy the requirements of Order No. 637.

**B. Scheduling Equality**

52. The April 11, 2002 order found that Southern had not fully complied with the Commission's scheduling equality requirements of Section 284.12(b)(1)(ii) of the Commission's regulations. Southern was directed to either revise its tariff to clarify that the releasing shipper may inform the pipeline of a prearranged deal at any time and the replacement shipper may nominate at the next available opportunity after the pipeline is so informed or to implement the revised North American Energy Standards (NAESB) capacity release timeline found in Version 1.5 of the NAESB standard 5.3.2. In its May 13, 2002 filing, Southern proposed revised language to comply with the Commission's directives regarding scheduling equality, as discussed above. Subsequently, on August 1, 2002, Southern filed revised tariff sheets to comply with Order No. 587-O,[38] which adopted Version 1.5 of the NAESB standards. By letter order issued on September 30, 2002,[39] Southern's August 1, 2002 filing was conditionally accepted, effective October 1, 2002. Therefore, Southern's proposed tariff sheets

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[37](...continued)

> may decide the merits of the contested settlement issues, if the record contains substantial evidence upon which to base a reasoned decision or the Commission determines that there is no genuine issue of material fact.

[38]99 FERC ¶ 61,146 (2002).

[39]Unpublished letter order issued in Docket No. RP02-462-000.

addressing scheduling equality in the instant filing have been superceded and are rejected as moot.

### C. Segmentation

#### 1. Commission Requirement

53. The April 11, 2002 order accepted Southern's segmentation proposal with one exception. The Commission found Southern's proposal to limit intrazone segmentation in the reticulated areas of the system to be unacceptable, and directed Southern to revise its tariff to state that Southern will accept and evaluate segmenting requests in those areas where gas flow may be reversed, to specifically delineate the bounds of those areas, and to provide service to the extent operationally feasible. In addition, the Commission required Southern to file a report within 60 days after Southern has implemented segmentation for one year, proposing any modifications and justifying the continuation of any restrictions on segmentation.

#### 2. Southern's May 13, 2002 Compliance Filing

54. In proposed Section 12.1(l)(2) of its GT&C, Southern has developed a list of 12 criteria that it will use to evaluate whether segmented transactions in the reticulated areas delineated on Sheet No. 5B[40] can be scheduled. Southern states that the listed evaluation factors for the reticulated area are operating criteria that are commonly used to evaluate operational conditions on the system for all types of transactions, not just segmented transactions in the reticulated areas. However, with the multi-directional flow that is characteristic of the reticulated areas on Southern's system, the pipeline asserts these operational conditions can magnify the difficulty of scheduling transactions. Southern further explains that because the reticulated areas are affected by north system and south system flow patterns, a key factor that Southern will use in determining whether segmentation is feasible will be the proportion of north to south volumes serving the reticulated area based on historic patterns of flow so that parties segmenting in or to the reticulated area will not overlap their capacity. The other criteria that Southern will utilize are: (1) the sources of flowing gas supply, including whether actual volumes flowing into the system are consistent with scheduled volumes; (2) injection and withdrawal activity and storage inventory levels at the pipeline's storage facilities; (3) for

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[40]Sheet No. 5B is a map showing the reticulated areas on Southern's system. To the extent the delivery or receipt points within a reticulated area change, Southern will post such changes on SoNet Premier as specified in the tariff provision.

displacement transactions, the corresponding scheduled volumes that physically support the ability to confirm the displacement nominations; (4) the proportion of volumes historically flowing from the north and south main system to point(s) in the reticulated area; (5) facilities outages; (6) whether any part of the segmented transaction is a backhaul; (7) whether the system is already experiencing operational difficulties such that the affected reticulated area is under an OFO; (8) delivery pressures relative to contractual obligations; (9) changes in the level and direction of line inventory; (10) the projected requirements under Rate Schedule FT-NN in or affected by service in the reticulated area; and (11) the pipeline's obligation to deliver other shipper's Daily Entitlements.

**3. Comments**

55. The Municipals oppose the adoption of the 12 criteria for evaluating segmentation requests in the reticulated areas unless and until Southern can demonstrate that the implementation of the proposed criteria will ensure that there is no curtailment or other degradation of firm services. They assert that curtailment of firm service is a situation where segmentation is not operationally feasible and thus cannot be required under Order No. 637.

56. DETM argues that the 12 criteria Southern will consider when evaluating the operational feasibility of segmented transactions within the reticulated areas provide neither a formula for determining how such criteria will be evaluated, nor a procedure under which shippers may request segmented transactions in the reticulated areas. In order for the 12 criteria to form the backbone of a meaningful segmentation program, DETM asserts that several additional components are required. First, DETM asserts shippers need a process for submitting segmentation requests that ensures that Southern engages in a legitimate operational analysis of requests when determining feasibility. While DETM would prefer that this process be self implementing as is the case with segmented transactions in the non-reticulated area, DETM asserts that it is unlikely Southern will have an opportunity to evaluate the 12 criteria within the time frames provided by the NAESB nomination cycles and instead will more likely deny a segmentation nomination without engaging in a thoughtful review of the 12 criteria.

57. Second, DETM states that, for the 12 criteria to provide an accurate barometer for determining whether a segmented transaction is operationally feasible, the Commission and shippers need to know how the criteria will be interpreted. It argues that for the criteria to have any meaning, they must be tied into a standard (e.g., Southern will grant a requested segmented transaction if, after evaluating the 12 criteria, it determines that the transaction can be performed without preventing Southern from meeting its firm

contractual obligations). Third, DETM states that there must be transparency and accountability in the process. DETM requests that the Commission require Southern to provide a timely and written explanation in all instances in which a requested segmented transaction is denied and that this requirement be made a permanent component of the segmentation program.

### 4. Commission Ruling

58. The Commission finds that the 12 criteria Southern proposes to use to evaluate whether segmented transactions in the reticulated areas are operationally feasible and can be scheduled are reasonable. Southern's proposal provides a means of moving forward on its system toward greater flexibility for shippers in the reticulated areas of its system, while at the same time taking into account Southern's concerns about the operational effects of such segmented transactions. The Commission believes the proposal is beneficial in that it will permit the pipeline and its shippers to gain experience with these transactions. Additionally, this actual experience will be valuable when the Commission examines Southern's segmentation report to be filed one year after implementation.

59. We find that the Municipals' concern about curtailment or other degradation of firm services are adequately addressed by our acceptance of Southern's proposed criteria which provides Southern with reasonable criteria in evaluating whether to permit segmentation in the reticulated areas of its system. Indeed, one of the criteria that Southern will use to determine whether segmentation is feasible in the reticulated areas is whether it can meet its shippers' firm obligations.

60. We find merit in DETM's request that Southern must establish an appropriate process for submitting segmentation requests in the reticulated areas. Southern's tariff proposal in Section 12.1(l)(2) is silent in this regard. Southern is directed to explain and support the procedures it intends to use for these segmentation requests and to file revised tariff language consistent with its proposal.[41]

61. In addition, we will require Southern to post on its internet web site a report which describes the specific operational factors that caused it to deny a request for segmentation under Section 12.1(l)(2). As asserted by DETM, this requirement will provide

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[41] The Commission has accepted proposals to establish special procedures for processing segmentation requests for reticulated systems when supported by the operational complexity of the system. See Colorado Interstate Gas Co., 95 FERC ¶ 61,321 (2001).

transparency and provide shippers with the information necessary to monitor Southern's implementation of segmentation within the reticulated areas. Finally, the Commission will require Southern to clarify Section 12.1(l)(2) of its tariff to provide that it will grant requests for segmentation in the reticulated areas if it determines it is operationally feasible, as requested by DETM.

62. With these modifications, the Commission finds that Southern's segmentation proposal for the reticulated areas on its system complies with the Commission's directives in the April 11 order.

63. However, in Interstate Natural Gas Association of America v. FERC, 285 F.3d 18 (D.C. Cir. 2002) (INGAA), the United States Court of Appeals for the District of Columbia Circuit remanded aspects of Order No. 637 to the Commission. On October 31, 2002, the Commission responded to the court's remand and, in ordering Paragraph B, directed that pipelines, that the Commission found must permit segmentation on their systems, file revised tariff sheets to expressly permit segmented transactions consisting of forwardhauls up to contract demand and backhauls up to contract demand to the same point at the same time.[42] Southern to date has not complied with this requirement. Accordingly, Southern is directed to file revised tariff sheets to comply with the Commission's remand order.

### D. Mainline Priority

#### 1. Commission Requirement

64. In the April 11, 2002 order, the Commission found that Southern only partially complied with the requirements of Order No. 637-A regarding mainline priority at secondary points because it did not propose to establish a within-the-path priority for Exhibit A-1 Receipt Points.[43]

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[42] Regulation of Short-Term Natural Gas Transportation Services, and Regulation of Interstate Natural Gas Transportation Services, Docket No. RM98-10-011, 101 FERC ¶ 61,127 (2002).

[43] Under Southern's tariff, shippers can nominate at Exhibit A (firm) receipt points and at Exhibit A-1 (secondary) receipt points.

### 2. Southern's Proposal

65. Southern has revised Sections 6.4 and 12.3 of its General Terms and Conditions (GT&C) to afford a higher priority to Exhibit A-1 receipt points within the path of the Exhibit A receipt point contained in the service agreement than to shippers utilizing Exhibit A-1 receipt points outside the path of the Exhibit A receipts points contained in the service agreement. Southern has further provided that, to the extent a firm shipper nominates receipts from a pool and the pool has not been transferred to the shipper's firm receipt point authority, such receipts will not be eligible for a within the path priority. In addition, Southern explains that some shippers on its system do not have firm Exhibit A receipt points and therefore will not be assigned a within the path priority because there is no firm receipt point in which to determine a shipper's path.

### 3. Commission Ruling

66. Southern has satisfactorily complied with the Commission's April 1, 2002 order regarding this issue.

## E. Discount Provisions

### 1. Commission Requirement

67. The April 11, 2002 order required Southern to implement the Commission's discount policy articulated in CIG/Granite State,[44] where 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 within two hours. The Commission reasoned that its discount and segmentation policies can best be balanced by adoption of a policy under which a shipper with a discounted rate that seeks to use an alternate receipt or delivery point (whether through segmentation, capacity release or its own exercise of flexible receipt or delivery points) can continue to receive a discounted rate if the pipeline has granted a discount to a similarly situated transaction at the alternative point.[45]

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[44] Colorado Interstate Gas Co., 95 FERC ¶ 61,321 (2001); Granite State Gas Transmission, Inc., 96 FERC ¶ 61,273 (2001) order on reh'g, 98 FERC ¶ 61,019 (2002).

[45] See Paiute Pipeline Co., 96 FERC ¶ 61,167, at 61,750 (2001) (explaining that the CIG discount policy applies to the use of secondary points whether through capacity (continued...)

68. Under this 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 to another point at which the pipeline has granted discounts for transportation services.[46] 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. The Commission placed the burden on the pipeline to justify a denial of a discount, because the Commission was concerned that pipelines may not have the same incentive to offer discounts to segmented transactions or to transactions using secondary points that compete directly with their sale of primary capacity.

69. In order to comport with the Commission's requirement to ensure nomination equality,[47] the Commission further has required pipelines to process requests for discounts within two hours of the time the request is submitted.[48] This processing requirement ensures that shippers requesting the continuation of discounts can submit nominations at each of the four standard nomination opportunities provided by the pipeline.

### 2. Southern's Proposal

70. Southern has added Sections 42.2 and 42.3 to its GT&C that established a rebuttable presumption that a shipper holding a discount that is limited to receipts from or deliveries to a specific receipt point or delivery point or both may retain a discounted rate if it elects to use an alternative Exhibit A-1 receipt point or Exhibit B-1 delivery point within the same zone or an upstream zone and Southern has granted a discount to a

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[45](...continued)
release transactions, segmentation, or the use of flexible receipt or delivery points).

[46]The shipper seeking to move its point will pay the higher of its contractual rate or the discount rate being offered at the alternative point. See CIG, 95 FERC ¶ 61, 321, at 62,121 n. 38.

[47]18 C.F.R. § 284.12 (b)(1)(ii) (2003).

[48]The Commission has provided that "if a pipeline and its shippers can reach agreement on a standard processing period for discount requests that retains the nomination equality requirement of the Commission's regulations, such an agreement also could be an acceptable method of implementing the discount policy." Granite State Gas Transmission Inc., 98 FERC ¶ 61,019 (2002).

similarly situated transaction at the alternative point.[49] A shipper may request to retain a discount by submitting a request in writing to the pipeline and Southern will respond to requests received between 7:00 a.m. and 4:00 p.m. CCT on a business day within two hours. If requests to retain a discount are received on non-business days, or after 4:00 p.m. and prior to 7:00 a.m. on a business day, Southern will respond by 8:30 a.m. on the next business day. A shipper retaining a discount at an alternative point shall pay the higher of its discounted rate or the lowest effective discounted rate provided to a similarly situated shipper at the alternative point.

### 3. Comments

71. While GIG states that it does not formally object to Southern's proposed language seeking to implement the rebuttable presumption for discounts that is limited to point changes within the same zones or zones upstream of the original point, it expresses concern that Southern's proposed language differs from that of CIG/Granite State which discusses discounts in terms of points, without reference to zones. GIG requests that the Commission carefully scrutinize Southern's CIG/Granite State proposal in this regard.

### 4. Commission Ruling

72. Southern has satisfactorily complied with the Commission's April 11 order regarding this issue. We also find that Southern's proposal to limit the applicability of the Commission's discount policy to point changes within the same or upstream rate zones for which a shipper has contracted for service is appropriate. The Commission's discount policy applies to the contractual discount that the shipper currently enjoys. When a shipper seeks to use a secondary point in a different zone than it has contracted for, there are different contractual considerations than when the new location is in the same zone(s) as its primary points.[50]

## F. Crediting of Penalty Revenue

73. In the April 11, 2002 order, the Commission directed Southern to revise its tariff to provide that all penalty revenues (net of costs) will be refunded to non-offending

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[49] In all other cases, Southern states the shipper will automatically be entitled to retain the discount when it is using secondary receipt or delivery points within the same or upstream rate zones for which it has contracted for service.

[50] See Natural Gas Pipeline Co. of America, 103 FERC ¶ 61,174 P 46 (2003).

shippers. As discussed above, the Commission grants clarification on this issue, finding that Southern's tariff already requires the crediting of penalty revenues to shippers. Thus, Southern's tariff is in compliance with Order No. 637 on this issue and no further revisions are necessary.

### G. Operational Flow Orders (OFOs)

#### 1. Commission Requirement

74. In the April 11, 2002 order, the Commission found that Southern's OFO provisions generally comply with the requirements of Order No. 637 to minimize the use and adverse impact of OFOs. We found that Southern's proposal provides for clear circumstances that give rise to an OFO and adequate notice of the implementation of an OFO. The April 11, 2002 order also found that Southern's proposal to divide its Type 3 OFO into three levels was not unusually complex, as asserted by GIG, but that it tailored the OFO level to the type of conditions faced by the pipeline according to the dictates of Order No. 637. Finally we found that Southern's proposed penalties for its Type 3 OFO are not excessive.[51]

#### 2. Southern's Proposal

75. Southern filed tariff changes to implement the changes approved by the Commission in the April 11 order including implementation of three levels for OFO Type 3 and adding an additional component to the existing fixed penalty amounts in its tariff for Type 3, Level 3 OFOs.

#### 3. Comments

76. GIG objects that Southern's proposed tariff modifications would create a more complicated OFO mechanism and more punitive penalty structure. GIG requests that the Commission reject those proposed modifications. Alternatively, GIG requests that the Commission set for technical conference Southern's proposed OFO mechanism and penalty changes in order to give the parties an opportunity to consider Southern's reasons for the proposals and to present alternative proposals.

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[51] Southern's proposal revises the penalty for its Type 3, Level 3 OFO to the greater of $15 per dth or twice the applicable daily Index price established in Gas Daily's "Midpoint Louisiana Onshore South" for any day in which the OFO is in effect. The current level for this type of penalty is $15 per dth.

#### 4. Commission Ruling

77. As discussed above, the Commission grants GIG's request to modify Southern's proposed Type 3, Level 3 penalty provisions to cap this penalty at the existing level of $15.00 per dth. Accordingly, Southern is directed to file revised tariff sheets consistent with this ruling. GIG's assertions regarding the complexity of Southern's OFO proposal are properly raised on rehearing and are addressed in the rehearing section of this order. In all other respects, we find that Southern has complied with the Commission's April 11, 2002 order on this issue.

### H. Implementation

78. In its May 13, 2002 compliance filing, Southern states that it can place its tariff changes into effect July 1, 2002, with the exception of segmentation and mainline priority at secondary points. However, if the Commission order on the compliance filing issues after June 15, 2002, Southern proposes to implement the tariff provisions on the first day of the month after the order issues, provided that it has at least 10 business days after the order issues to put the system changes into effect. Regarding segmentation and mainline priority at secondary points, Southern has filed pro forma tariff sheets because it states it will not be able to implement these changes prior to December 1, 2002. It proposes to file to place such sheets into effect at least 30 days prior to the proposed effective date. The Commission will require Southern to implement its Order No. 637 proposals on September 1, 2003. Southern is directed to file revised and actual tariff sheets reflecting the discussion in this order within 15 days of the date of this order.

The Commission orders:

(A) The requests for rehearing are granted in part and denied in part as discussed above.

(B) The tariff sheets listed in the Appendix A are accepted, to be effective September 1, 2003 subject to the conditions in this order.

(C) The tariff sheets listed in the Appendix B are rejected as moot.

(D) Southern is directed to file revised and actual tariff sheets consistent with the directives set forth in this order within 15 days of the date of issuance of this order.

By the Commission.

( S E A L )

Linda Mitry,
Acting Secretary.

APPENDIX A

Southern Natural Gas Company

Tariff Sheets Conditionally Accepted Effective September 1, 2003

FERC Gas Tariff, Second Revised Volume No. 1

First Revised Sheet No. OA
Second Revised Sheet No.43
Seventh Revised Sheet No. 44
Third Revised Sheet No. 57
Seventh Revised Sheet No. 58
Seventh Revised Sheet No. 62
Sixth Revised Sheet No. 63
First Revised Sheet No. 68
First Revised Sheet No. 69
Sixth Revised Sheet No. 72
Second Revised Sheet No. 73
Third Revised Sheet No. 78
Third Revised Sheet No. 79
Second Revised Sheet No. 84
Second Revised Sheet No. 87
Third Revised Sheet No. 88
Third Revised Sheet No. 92
Second Revised Sheet No. 93
First Revised Sheet No. 120
Second Revised Sheet No. 121
Third Revised Sheet No. 130
Second Revised Sheet No. 130A
Sixth Revised Sheet No. 131
Seventh Revised Sheet No. 142
Third Revised Sheet No. 142A
First Revised Sheet No. 151
Second Revised Sheet No. 152
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First Revised Sheet No. 165
Fifth Revised Sheet No. 169
Second Revised Sheet No. 170
Fourth Revised Sheet No. 176
Fifth Revised Sheet No. 181
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Eighth Revised Sheet No. 187
Third Revised Sheet No. 193
First Revised Sheet No. 212i
Original Sheet No. 212i.01
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Original Sheet No. 212i.06
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First Revised Sheet No. 212J
Third Revised Sheet No. 239
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APPENDIX B

Southern Natural Gas Company

Tariff Sheets Rejected

FERC Gas Tariff, Second Revised Volume No. 1

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Eighth Revised Sheet No. 275
Fifth Revised Sheet No. 276
Fifth Revised Sheet No. 277