

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, Joseph T. Kelliher,
and Suedeem G. Kelly.

Tennessee Gas Pipeline Company

Docket Nos. RP02-114-002
and RP02-114-003

ORDER ON REHEARING, CLARIFICATION
AND COMPLIANCE FILING

(Issued December 24, 2003)

1. This order addresses the net cashout gain refund plan filed by Tennessee Gas Pipeline Company (Tennessee) in compliance with the Commission's December 19, 2002 Order,¹ and requests for rehearing and clarification of that order. The Commission rejects Tennessee's proposed cashout refund plan, generally denies rehearing, and partially grants clarification of the December 19, 2002 Order. This order benefits Tennessee's customers by encouraging responsible behavior on Tennessee's gas transmission system and equitably allocating the cashout refunds among its customers.

I. Background

2. Tennessee maintains a Volumetric Transition Cost Account (VTCA), which was established to implement the recovery of take-or-pay costs Tennessee's customers owed it pursuant to Tennessee's Cosmic Settlement in Docket Nos. RP86-119, *et al.*² The Cosmic Settlement provided for Tennessee to recover take-or-pay transition costs up to a cap of \$1.3 billion under an equitable sharing methodology. The equitable sharing methodology required Tennessee to absorb 50 percent of the take-or-pay transition costs, classified 41.78 percent of the costs as demand costs recoverable from its customers under a demand transition cost account, and classified 8.22 percent of the costs as volumetric costs to be recovered from its customers in surcharges. The volumetric take-or-pay costs recoverable under the Cosmic Settlement were recorded in the VTCA and then the VTCA was divided into "Market Area" and "Supply Area" subaccounts, with 76.9 percent allocated to Market Area Shippers and 23.1 percent allocated to Supply Area

¹ Tennessee Gas Pipeline Company, 101 FERC ¶ 61,303 (2002) (December 19, 2002 Order).

² Tennessee Gas Pipeline Company, 52 FERC ¶ 61,045 (1990).

Shippers. The respective subaccount take-or-pay balances are recovered through volumetric surcharges applied, respectively, to Market Area and Supply Area shippers that take effect April 1 of each year. In addition, pursuant to a later settlement, Tennessee's balancing services Rate Schedules LMS-MA and LMS-PA³ require net cashout gains that Tennessee owes its customers to be allocated (credited) to the VTCA 76.9 percent to Market Area Shippers and 23.1 percent to Supply Area Shippers, the same way as take-or-pay costs are allocated to them. The tariff further provides that, if either the Market or Supply Area Volumetric Surcharge is terminated, the balance of the net cashout gain otherwise attributable to such terminated account is to be refunded and Tennessee must first file a refund plan with the Commission.⁴ However, the tariff is silent as to how the refunds are to be made. Finally, Tennessee's tariff provides that it must file an annual report setting forth the net cashout balance as of November 30 of each year.⁵

3. On November 30, 2001, Tennessee filed its 2001 annual cashout refund report. Tennessee reported that, as of October 31, 2001, it had a net total gain from cashouts of \$10,600,893. It also reported that it had a total combined VTCA balance of \$11,038,881 of which the vast majority (\$11,007,273) was in the Supply Area subaccount and only \$31,608 in the Market Area VTCA subaccount. Accordingly, under its tariff, Tennessee would have been required to allocate 23.1 percent of the total net gain (\$2,448,806) to the Supply Area VTCA subaccount and the remaining 76.9 percent (\$8,152,087) to the Market Area VTCA subaccount. After crediting the Supply Area VTCA subaccount, there still would have been a large balance of take-or-pay costs remaining in that subaccount to be amortized and recovered over time, which Tennessee estimated would take some seven years. However, because the take-or-pay balance in the Market Area VTCA subaccount was only \$31,608, the Market Area subaccount would have been paid down to zero after crediting the \$8,152,087 in net cashout gains allocable to the Market Area shippers, leaving a net negative balance of \$8,120,479 owed the

³ LMS-PA and LMS-MA stand for Load Management Service – Pooling Area and Market Area, respectively. Rate Schedule LMS-PA is a daily swing and monthly balancing service available to balancing parties at receipt points in Tennessee's pooling area. Rate Schedule LMS-MA is a daily swing and monthly balancing service available to balancing parties at delivery points in the market area.

⁴ Tennessee's FERC Gas Tariff, Third Revised Volume No.1, Sheet No. 393.

⁵ Tennessee's FERC Gas Tariff, Fifth Revised Volume No. 1, Sheet Nos. 209A and 217.

Market Area shippers with no expectation of significant future take-or-pay payments that could be charged to the Market Area VTCA subaccount. Rather than trying to apply the tariff procedures in this circumstance, Tennessee sought a waiver of its tariff to be allowed to credit the entire \$10,600,893 cashout gain balance to the combined VTCA balance of \$11,033,881, treat the combined VTCA balance of \$11,038,881 in take-or-pay costs as being reduced to zero, absorb the difference, and be at risk for any future take-or-pay costs Tennessee incurs, and terminate the take-or-pay provisions of its tariff.

4. In an order issued January 17, 2002, the Commission rejected Tennessee's waiver proposal and ordered Tennessee to file a revised refund plan within 30 days.⁶ The Commission found that the tariff clearly provides for the disposition of these funds, citing the refund requirement of the tariff. The Commission agreed with the protesters that Tennessee's proposal would result in an unjust subsidization of Supply Area take-or-pay costs by Market Area shippers since, of the total take-or-pay balance of the VCTA at the time of its refund report, \$11,007,273 in take-or-pay costs remained in the Supply Area shippers' subaccount, whereas only \$31,608 remained in the Market Area shippers' subaccount. The Commission found that to apply the entire net cashout gain to reduce the overall take-or-pay balance would result in unjust cost-shifting and would unfairly burden Market Area shippers with take-or-pay costs they were not allocated under the Cosmic Settlement.

5. On February 15, 2002, Tennessee filed a revised refund report to comply with the January 17, 2002 Order.⁷ Tennessee proposed the following disposition of the net cashout gain of \$10,600,893: (1) 23.1 percent (\$2,448,806) would be credited to the Supply Area Volumetric Surcharge Account; (2) \$31,608 would be credited to the Market Area Surcharge Account, zeroing out the Market Area take-or-pay account balance; and (3) the remaining 76.9 percent (\$8,120,479) in net cashout gains would be refunded to all firm shippers, pro rata, based on contract quantities effective from September 1, 2000, through August 31, 2001. For FT-GS shippers, contract quantities would be assumed at a 60 percent load factor. In its comments to the technical conference, Tennessee reflected four alternative allocation methods proposed by the parties. The first alternative (Case A), which Tennessee asserted was the most equitable, was for the \$8,120,479 to be allocated pro rata, based on firm contract quantities effective from September 1, 2000 through August 31, 2001, as it proposed in its February 15,

⁶ Tennessee Gas Pipeline Company, 98 FERC ¶ 61,034 (2002).

⁷ On June 24, 2002, Staff held a technical conference in this proceeding to address the cashout revenue refund report.

2002 compliance filing. For FT-GS shippers, contract quantities would be assumed at a 60 percent load factor. Case B would allocate the refunds to all transportation customers pro rata based on billed revenues. Case C would allocate the refunds by first splitting the refunds into what it asserted could be classified as "cashout penalty" (\$1,851,487) and non-penalty (\$6,268,912) amounts. The "penalty" amount would then be refunded to balancing parties that were not billed under the cashout mechanism; the remaining portion would be refunded pro rata to transportation customers based on billed revenues. Case D would use the allocations under Case C but would refund the imputed "non-penalty" portion of the refunds to transportation and storage customers. Parties filed protests to Tennessee's February 15, 2002 compliance proposal for the disposition of the remaining \$8,120,479 net cashout gain balance.

6. In the December 19, 2002 Order, the Commission accepted Tennessee's application of the cashout revenues to the Supply Area and Market Area VTCA subaccounts, as prescribed by the tariff under the Cosmic Settlement in Docket Nos. RP86-119, et al. However, the Commission rejected Tennessee's and other parties' alternative proposals for refund of the remaining \$8,120,479 net cashout gain balance. The Commission found that, after fulfilling the obligation under the Cosmic Settlement, the residual revenues still were, by their nature, cashout revenues and should be refunded as such to the source of the cashout revenues, i.e., the point operators on Tennessee's system pursuant Operational Balancing Agreements (OBA) at each such point. The Commission held that cashout revenues, once they are no longer required to be credited to the VTCA, no longer acquire a take-or-pay character and, instead, retain their cashout character. Accordingly, in that circumstance, the Commission held that the net cashout gains at issue should be refunded without reference to the take-or-pay allocation principles of the Cosmic Settlement. Further, the Commission observed that the monies comprising the cashout revenues are from a variety of sources such as storage, and daily imbalance charges. The Commission found that, after this "melting pot" of revenues is netted the resulting excess, which is to be refunded, is indistinguishable as to what portion may be penalty or non-penalty. Accordingly, the Commission rejected all of Tennessee's and the other parties various alternative refund proposals and directed Tennessee to refile its refund plan to reflect the refund of the \$8,120,479 back to its point of origin, the OBA point operators. To further encourage positive behavior on Tennessee's system, the Commission required that the cashout revenues be refunded to "non-offending point operators,"⁸ calculated pro rata monthly based on the point

⁸ The Commission defined "non-offending point operators" as those parties who are within the first zero to five percent imbalance tier or 1,000 Dth as outlined in Tennessee's LMS-MA and LMS-PA rate schedules. 101 FERC ¶ 61,303 at P 28.

operator's cumulative volumes, to be distributed no less than annually, with interest as set forth in Section 154.501(d) of the Commission's regulations.⁹

7. On January 21, 2003, Tennessee made its filing to comply with the December 19, 2002 Order. Tennessee and various parties request clarification or, alternatively, rehearing of the Commission's December 19, 2002 Order. The issues raised by the compliance filing and requests for rehearing are addressed below.

II. Rehearing and Clarification

A. Who Should Receive Net Cashout Gain Refunds

1. Clarification Regarding LMS-PA and LMS-MA Parties

8. In the December 19, 2002 Order, the Commission directed that the net cashout gains should be distributed to all non-offending OBA point operators where the money originated in a manner similar to how the money was collected, *i.e.*, based on commodity volumes. The Commission found that neither the Commission nor Tennessee has the information to determine who the non-offending shippers are behind the OBA point operator's point. Further, the Commission held that flowing the refund dollars back to non-offending OBA point operators will also encourage good behavior on Tennessee's system.

9. Tennessee requests clarification of the statement in the December 19, 2002 Order that the cashout refunds should go back to where "the money originated," and asks if it is the Commission's intent that all balancing parties that fall under the cashout provisions of rate schedules LMS-MA and LMS-PA are eligible for refund, not just the OBA point operators. The Dominion LDCs¹⁰ also request clarification on this point.

10. We will clarify our previous order as requested. Tennessee is correct that the Commission intended for all balancing parties under the cashout provisions of Rate Schedules LMS-PA and LMS-MA, who are subject to penalties, to be eligible for refunds under the refund mechanism crafted here, and not just the OBA point operators. This refund mechanism is consistent with Tennessee's scheduling imbalance penalty

⁹ See *id.*

¹⁰ East Ohio Gas Company d/b/a Dominion East Ohio, and The Peoples Natural Gas Company d/b/a Dominion Peoples.

mechanism, whereby eligible parties for penalty credits are 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.”¹¹ In addition, based on Tennessee's LMS rate schedules, "shippers" include point operators along with any additional parties listed in Tennessee's LMS rate schedules.¹² Furthermore, under Tennessee's tariff, it is the balancing parties and point operators that pay the imbalance charges and, thus, should receive any net cashout refunds.

2. Allocation of Refunds to Both Market Area and Production Area OBA Point Operators

11. In the December 19, 2002 Order, the Commission directed that the net cashout gains should be distributed to all non-offending OBA point operators without respect to whether the shippers behind each such point are Market Area or Supply Area.

12. Keyspan questions why the Commission believes that its December 19, 2002 Order will not create a subsidy for Supply Area shippers to the same extent or greater than Tennessee's original proposal to credit its cashout over-recovery to its Supply Area take-or-pay balance, given the Commission's previous ruling in its January 17, 2002 Order, that it would be unreasonable to require Tennessee's Market Area shippers to subsidize Supply Area shippers, and the fact that all cash is fungible. KeySpan requests rehearing of the December 19, 2002 Order to the extent the Commission does not, or cannot clarify why its ruling is reasonable.

13. The Commission has reconsidered its ruling on this issue and has determined to grant rehearing and require the allocation of the remaining \$8,120,479 in net cashout gains only to Market Area shippers, OBA point operators and parties to LMS-MA service agreements. This is consistent with the January 17, 2002 Order and with the intent of the Cashout Settlement. Under the Settlement and resulting tariff, the VTCA is to be the vehicle for pass through to Tennessee's customers of credits for net cashout gains. Thus, 23.1 percent of any total net cashout gain is to be credited to Supply Area shippers and 76.9 percent is to be credited to Market Area shippers. Because the Supply Area VTCA still has a large take-or-pay balance, the Supply Area VTCA is still a viable vehicle to

¹¹ Tennessee Gas Pipeline Co., 99 FERC ¶ 61,017 (2002), order on reh'g, 104 FERC ¶ 61,063 at P 63 (2003), reh'g pending.

¹² Tennessee's FERC Gas Tariff, Fifth Revised Vol. No. 1, Third Revised Sheet No. 2 of the General Terms & Conditions.

pass through 23.1 percent (\$2,448,806) of the total net cashout gain of \$10,600,893 to the Supply Area shippers via a reduction in the Supply Area VTCA balance. However, because the take-or-pay balance in the Market Area is negligible and is insufficient to absorb the 76.9 percent (\$8,120,479) in net cashout gains attributed to the Market Area shippers, the Market Area VTCA is no longer a viable vehicle to pass through the \$8,120,479 in net cashout gains to the Market Area shippers and the parties agree that this amount must be refunded. Under the tariff, but for the lack of a sufficient balance of take-or-pay costs in the Market Area VTCA account to absorb the remaining 76.9 percent (\$8,120,479) in net cashout gains, Market Area shippers (including Market Area OBA parties) would be allocated 100 percent of that remaining balance. Accordingly, although the Settlement and tariff are silent as to how refunds are to be implemented, we find that the context in which this refund amount arose, *i.e.*, the Settlement and tariff procedures, should be considered in fashioning an equitable solution to the question of how the refunds are to be implemented. Given that context, as discussed above, it is equitable and reasonable that the \$8,120,479 remaining balance be refunded only to Market Area shippers and OBA parties. We agree with KeySpan that, to provide for a further allocation of some portion of that \$8,120,479 balance to Supply Area shippers after having already allocated \$2,448,806 of the net cashout gains to them under the tariff procedures, would constitute an inequitable subsidy by the Market Area shippers. Having received their full allocation of 23.1 percent of the total net cashout gain pursuant to the tariff procedures, Supply Area shippers have received credit for all that they are due under the Settlement and tariff and have no legal or equitable claim to any more. Tennessee is directed to file a revised refund plan in accordance with this ruling within 30 days of this order.

3. Allocation of Net Cashout Revenues to Parties Maintaining Imbalances Within Tolerances

14. In the December 19, 2002 Order the Commission found that all the net cashout revenues should be refunded back to "non-offending point operators", defined as those whose imbalances fall within a zero to five percent tolerance or 1,000 Dth set forth in the tariff, who would then refund the amounts to shippers as per their individual contracts with the point operators. In so ruling, the Commission determined that it was impossible to classify portions of the cashout revenues as penalty or non-penalty because cashout revenues were not collected under separate penalty and non-penalty accounts.

15. On rehearing, National Fuel requests that the Commission reconsider its decision, and instead, authorize allocating 100 percent of what it asserts is the penalty portion of the cashout to Balancing Parties, while allocating 100 percent of what it asserts is the non-penalty portion of the cashout to transportation customers who, it asserts, pay for the

balancing assets. National Fuel argues that "...when Tennessee makes a cashout sale by encroaching system inventory, Tennessee records the cost of that encroachment at the current month market price."¹³ Further, it asserts, "[w]hen Tennessee cures that encroachment, Tennessee 'trues up' the initial encroachment valuation by crediting or debiting the encroachment account between the market price . . . and the replacement cost."¹⁴ National Fuel asserts that this repayment portion is simply compensation at the market index price, and therefore, it asserts, non-penalty in nature.

16. Thus, National Fuel reiterates its position in its comments on the February 15, 2002 compliance filing that any balancing cost falling within the 5 percent band is not a penalty, because the cost assignment within that band is 100 percent of an index price, and any gains are only due to the timing difference between when the gas was used and when the financial cashout takes place.

17. National Fuel asserts that the refund of what it claims are non-penalty dollars should be credited to firm transportation customers based on billed revenues. It argues that these dollars are generated from replenishing or selling system gas over time. The dollars received from or paid to cashed-out parties, National Fuel argues, are "Timing Difference Gains" or simply gains (e.g., \$6,268,992 of the total \$8,120,479 at issue), which it asserts are "non-penalty." National Fuel states that, therefore, only the remaining \$1,851,487 are "penalty" and should be distributed according to the December 19, 2002 Order, not the entire \$8,120,479. National Fuel argues that because "Timing Difference Gains" are non-penalty gains, the Commission erred in ordering these gains to be refunded in accordance with Order No. 637 penalty policy in its December 19, 2002 Order.

18. National Fuel further argues that the Commission erred in its finding that Tennessee could not isolate the penalty portion of the cashout revenues. National Fuel points out that Tennessee divided the refund into penalty and non-penalty portions in its

¹³ National Fuel Request for Rehearing at 5.

¹⁴ National Fuel quotes Tennessee's explanation of its method of determining penalty and non-penalty cashouts in Tennessee's reply comments, dated April 29, 1998, in Docket No. RP95-64-003, *et al.*

Case C allocation proposal¹⁵ regardless of the fact that the cashout proceeds are not divided by Tennessee into separate penalty and non-penalty subaccounts. According to National Fuel, Tennessee's Case C proposal is contrary to the Commission's decision that a penalty and non-penalty separation could not be made, due to the lack of subaccounts. National Fuel asserts that the Commission should require the use of separate subaccounts in Tennessee's compliance filing if it finds them necessary to facilitate the distribution of funds in penalty and non-penalty forms. National Fuel claims that Tennessee accurately calculated the penalty and non-penalty components of the refunds and points out that the calculations were unchallenged by other parties, thus there is no basis to assume the amounts are incorrect. Therefore, National Fuel asserts that the Commission made and relied on incorrect factual assumptions that a penalty and non-penalty separation of the refund was not possible.

19. At the outset, the whole matter of whether the net cashout gains at issue here are or are not penalties is irrelevant. Declining to require a distinction between penalty and non-penalty net cashout revenues is consistent with the existing tariff and underlying settlements. The tariff's mechanism for the crediting of net cashout revenues to reduce take-or-pay charges does not distinguish between penalty and non-penalty cashout revenues; all net cashout revenues are credited.

20. Moreover, even if relevant, contrary to National Fuel, we find that cashout imbalances within the initial 0 to 5 percent or 1,000 Dth tier are penalties and, therefore, none of the net cashout gains can be classified as "non-penalty." Under Tennessee's tariff, all imbalances within the initial 0 to 5 percent or 1,000 Dth tier are priced at high/low index prices that do not represent the average market price and which, therefore, are penalties. For example, for negative imbalances, Tennessee assigns a monthly averaged high index price, so if a customer is within the 5 percent tier, but underdelivers by 2 percent, the customer is required to pay a premium price in comparison to what the customer might have typically paid during the actual time of the occurrence. Likewise, for overdeliveries within the 5 percent tier, customers are paid an index price that is the monthly averaged low price, which presumably is lower than the price they typically could have received for the sale of the imbalance volumes when the imbalance occurred.

¹⁵ 101 FERC ¶ 61,303 at P 18. Case C is a separate allocation of refunds, splitting the refunds into two portions. The "penalty" portion (\$1,851,487) would be refunded to balancing parties that were not billed under the tiered cashout mechanism based on the absolute value of cashout quantities for that period. The "non-penalty" portion (\$6,268,912) would be refunded to transportation customers pro rata based on billed revenues.

Thus, as a high/low index price mechanism, all cashouts under Tennessee's tariff are penalties, even those within the initial imbalance tier.¹⁶ Further, for the same reason, its argument that Tennessee should be required to separately account for penalty and non-penalty cashout gains is without merit. Accordingly, rehearing on this issue is denied.

21. PSEG, New England LDCs and others assert that the Commission's allocation methodology based on imbalance volume absolute values requires reexamination, as it perversely encourages irresponsible behavior. PSEG uses the example of two parties within balance (within the 5 percent bandwidth), Party A and Party B, assuming that Party B has an imbalance of 4.99 percent, while Party A has a zero imbalance. Under the Commission's refund methodology, PSEG claims, Party B would receive a significant refund even though Party B had the higher imbalance, while Party A would receive no refund for a perfect balance, because it asserts that the Commission ruling that refunds would be based on imbalance volumes. PSEG and New England LDCs state that this method encourages imbalance activity.¹⁷

22. As discussed below in clarifying the December 19, 2002 Order, the Commission did not intend that the allocation of net cashout revenues to shippers and OBA parties whose volumes are within the 5 percent or 1,000 Dth tolerance would be based only on the imbalance volumes; rather, the shipper or OBA parties entire month's commodity volumes, inclusive of the imbalance volumes is to be utilized. Accordingly, PSEG's and New England LDCs' objections are misplaced.

4. Rejection of Refund Allocations Limited to Firm Shippers

23. KeySpan questions why the Commission chose to provide the cashout over-recovery to OBA point operators, who are assessed or receive market prices for volumes, rather than firm shippers who, it asserts, pay the fixed costs of the system.

¹⁶ See also Texas Gas Transmission Corporation, 97 FERC ¶ 61,349 at 62,631 (2000) (where the Commission found that a high/low index price could be deemed a penalty because it goes beyond compensating the pipeline for actual costs).

¹⁷ See PSEG Request for Rehearing at 5, New England LDCs Request for Rehearing at 4.

24. New England LDCs¹⁸ state that the Commission has previously ruled in a number of cases that cashout over-recoveries should be credited to pipeline shippers.¹⁹ In addition, New England LDCs asserts that in Midwestern Gas Transmission Company,²⁰ the Commission approved a cashout refund plan allocating excess revenues to shippers based on contract entitlements, exactly as proposed in the technical conference on June 24, 2002, and in New England LDCs initial and reply comments to the conference. New England LDCs also argues that the Commission rejected this same proposal in the December 19, 2002 Order without any support or justification.

25. National Fuel states that the mechanism ordered in the December 19, 2002 Order fails to reflect the nature of Tennessee's balancing system and the history involved in resolving Tennessee's cashout mechanism. National Fuel and New England LDCs both assert that parties who fund the cashout mechanism through transportation charges and bear the costs required to permit the operation of the cashout process should be considered in the refund mechanism. National Fuel asserts that the cashout system would not be possible without the benefit of system storage, linepack, and other system assets. National Fuel asserts that the use of these system assets is the source of the gain now at issue, and not Balancing Parties, as stated in the December 19, 2002 Order. Therefore, National Fuel requests that the Commission refund the gain to the parties who pay for the system assets, which they assert are the firm shippers.

26. National Fuel and New England LDCs further assert that the Commission's December 19, 2002 Order will provide a windfall to Balancing Parties who pay none of the costs associated with the assets that make the balancing available. National Fuel states that although these gains are not penalty gains, the gains are being refunded

¹⁸ The New England Local Distribution Companies include the following companies: The Berkshire Gas Company, Connecticut Natural Gas Corporation, Fitchburg Gas and Electric Light Company, City of Holyoke, Massachusetts Gas and Electric Department, NSTAR Gas Company, The Providence Gas Company, The Southern Connecticut Gas Company, Valley Gas Company, and Yankee Gas Service Company.

¹⁹ Citing Texas Gas Transmission Corporation, 64 FERC ¶ 61,803 at 61,814 (1993); ANR Pipeline Company, 64 FERC ¶ 61,140 at 62,074 (1993); and Viking Gas Transmission Company, 61 FERC ¶ 61,104 at 61,681 (1992).

²⁰ Unreported Director Letter Order, in Docket No. RP99-258-000, et al., dated April 12, 1999.

according to the Commission policy laid out in Order No. 637 which refunds non-offending shippers.

27. National Fuel states that neither the Commission nor balancing parties have proven that the refunds, once passed on to the non-offending balancing parties, will be passed on to shippers behind the balancing parties receipt and delivery points. National Fuel asserts that the contrary will happen, that balancing parties will reap a windfall, without passing the refunds on, as directed in the December 19, 2002 Order.²¹ National Fuel claims that whether refunds are passed back to shippers behind the balancing parties' point depends on if that shipper is a non-offending party as well as, and perhaps more importantly, the individual contract between the balancing party and the shipper.

28. National Fuel asserts that, if the Commission instead grants rehearing and orders that refunds be passed on to firm shippers, all of the refund money that National Fuel receives would be flowed back to the customers. National Fuel believes that this is the majority position of firm shippers.

29. PSEG continues to advocate Tennessee's February 15, 2002 filing's Case A allocation method which distributed the cashout refund based on firm contract quantities in effect from September 1, 2000 through August 31, 2001. PSEG argues that the allocation of refunds in the December 19, 2002 Order is inconsistent with Commission policy and does not encourage responsible behavior on the system.

30. The Commission finds the foregoing arguments are without merit and denies rehearing. The question of who should receive refunds of net cashout gains turns on who pays the cashout amounts in the first place, which generally are point operators, but also may be LMS-PA and LMS-MA customers. In the end, the Commission has chosen what it believes to be the most reasonable and equitable way to allocate refunds back to the entities that pay cashouts in the first instance, consistent with the underlying tariff and settlements. In light of the parties' failure to reach an accord on what the methodology should be, the Commission used its reasonable judgment to establish a fair, reasonable and equitable allocation methodology under the unique circumstances of this case. In response to the concerns raised over the possibility of OBA operators unjustifiably retaining refunds, shippers behind each point can be presumed to have an agreement with the point operators to deal with refunds, just as they can be presumed to have agreements covering reimbursement for the cashout payments themselves, and will recoup their appropriate share of the refunds through those agreements. Further, this is not a revenue

²¹ Citing 101 FERC ¶ 61,303 at P 26-27.

requirement such that the matter of who pays the fixed costs of the system is relevant. In any event, interruptible shippers also pay for the fixed costs of the system in their rates, which are designed on a 100 percent load factor basis. Finally, the parties are free to raise these rate-related arguments in Tennessee's next general Section 4 rate case proceeding.

31. National Fuel requests that, if the Commission fails to grant rehearing, the Commission should grant clarification on two points. First, National Fuel asks whether the risk of cashout losses would no longer be applied to firm shippers in the future, but instead be established as the sole responsibility of balancing parties since, it asserts, balancing parties would reap the benefits of cashout. Second, National Fuel requests clarification that Tennessee must address this issue in its next rate case and allocate the appropriate costs to the balancing services to cover the costs of the assets relied upon for balancing. It asserts that, absent these clarifications, the Commission's determination is solely a windfall for the balancing parties and is inequitable to the system's firm shippers.

32. National Fuel's requests for clarification are misplaced and will be rejected. The issue in the instant proceeding is how to refund net cashout gains, not whether to modify the tariff regarding the treatment of net cashout losses, which was the result of settlement. Further, its request for clarification regarding a reallocation of costs assumes that Tennessee's rates are not properly designed. We cannot assume that and, in any event, those rates are not appropriately at issue here; only refunds of net cashout gains are at issue. National Fuel is free to pursue these arguments in Tennessee's next general Section 4 rate filing proceeding.

B. Other Clarifications of the Required Allocation Methodology

33. KeySpan requests clarification of the Commission's meaning in the following underscored language: "A pro rata allocation factor to refund the over collection should be determined on the cumulative volumes from non-offending OBA point operators." In particular, KeySpan asks the Commission if "cumulative volumes" include all volumes received or delivered at individual receipt and delivery points, and whether these volumes include imbalance volumes. KeySpan uses the example of an OBA point operator at a delivery point that has a positive imbalance of 4,000 Dth out of 100,000 Dth total deliveries through this particular delivery point in a given month. KeySpan asks if the imbalance quantity in this scenario would be included in the determination of the cumulative volumes for which the refund would be based.

34. KeySpan requests further clarification of whether OBA point operators having monthly imbalances of between 0 and 5 percent (or less than 1,000 Dth) being refunded a

portion of the cashout revenues include those operators whose imbalance volumes reduce the size of the overall net cashout revenues.

35. The Commission stated in its December 19, 2002 Order that "[T]he Daily Imbalance Charge and cashout revenues are derived from the commodity volumes from the OBA operators, so any excess revenues to be allocated should be returned to non-offending OBA point operators in the same manner."²² The Commission intended that the allocation of refunds be based on all commodity volumes for the month, for both the volumes in balance and the volumes between 0 and 5 percent (or less than 1,000 Dth). Since the balancing parties bear the potential risk when putting the commodity into the system, it is reasonable to distribute the refunds on the basis of total commodity volumes because the greater the volume shipped, the greater the effort needed to remain in imbalance. For example, if Party A is out of balance by 400 Dth out of a 1 million Dth commodity volume and Party B is out of balance by the same amount yet has only a 10,000 Dth commodity volume, Party A has made more of a commendable effort to remain in balance than Party B even though both are within the tariff's imbalance tolerances, within the 5 percent or 1,000 Dth tolerances. Further, imbalance volumes should not be excluded since all volumes must be within the 5 percent or 1,000 Dth tolerance to qualify for a refund. Therefore, we clarify that the refund allocation method must reflect a refund based on total monthly commodity volumes for eligible parties, inclusive of imbalance volumes. Further, all Market Area shippers and parties are eligible to share in the refunds irrespective of whether they had positive or negative imbalances, as long as their imbalances fall within the allowed tolerances.

36. KeySpan also requests that the Commission clarify the meaning of the statement that "non-offending parties would be determined on a monthly basis." KeySpan asks if the Commission means that being an offending party within a given month would only disqualify that OBA operator for that month? In other words, could a shipper be an offending party 11 months out of the year, but still get refunds for the month the shipper was not an offending party?

37. KeySpan's understanding of how imbalances are to be determined is correct. Any imbalances within a month will only disqualify a shipper or OBA party for that month. In this manner, shippers and OBA parties who are within the imbalance tolerance for a given month will not be penalized for exceeding those tolerances in any of the other 11 months of the year. Accordingly, they receive a positive incentive for staying within

²² 101 FERC ¶ 61,303 at P 27.

the imbalance tolerances for that month by receiving a share of the net cashout refunds based on their commodity volumes for that month.²³

38. Finally, KeySpan requests clarification that the December 19, 2002 Order is tailored to the facts and circumstances of the Tennessee system only and is not intended to establish a policy to be applied on other pipeline systems.

39. KeySpan is correct that the December 19, 2002 Order is unique to the Tennessee cashout mechanism. The Commission is not establishing a general policy with this order and is simply applying the most reasonable and equitable solution to a unique problem that the parties were unable to resolve among themselves.

C. Interest

40. In the December 19, 2002 Order the Commission directed Tennessee to distribute cashout revenues on no less than an annual basis, with interest consistent with Commission policy in the manner prescribed in Section 154.501(d) of the Commission's regulations. Tennessee requests that the Commission grant rehearing and reverse its prior decision to require the calculation of interest in the cashout refund allocation method. Tennessee states that interest should not be included in the distribution because interest is not a component in determining the Net Cashout Balance under Tennessee's Cashout Settlement.²⁴

41. Tennessee states that the Commission's application of Section 154.501(d) of the Commission's regulations requiring interest calculations deals with refunds that are a result of increased rates and charges found by the Commission to be unjust, or approved by the Commission for refund as part of a settlement. While the instant refund involves a settlement, the settlement contained no provisions regarding interest in the event of a positive balance, as is the case here. Tennessee concludes that in the December 19, 2002 Order, the Commission inadvertently included language requiring Tennessee to distribute the revenues with interest. Further, Tennessee asserts that the omission of language requiring interest calculations on cashout revenues in Tennessee's cashout settlement was intended, as all parties specifically negotiated the omission of interest

²³ This is consistent with *Stingray Pipeline Company*, 98 FERC ¶ 61,367 at 62,587 (2002) and *Enbridge Pipelines (KPC) (Formerly, Kansas Pipeline Company)*, 99 FERC ¶ 61,208 (2002).

²⁴ Citing *Tennessee Gas Pipeline Co.*, 87 FERC ¶ 61,106 (1999).

calculations in the cashout mechanism. Tennessee states that, in fact, the tariff specifically outlines in great detail the only items to be included in the calculation of "Transporter's Net Cashout Balances," which do not include interest.

42. We agree with Tennessee. The tariff does not provide for interest on the cashout gains to be, either positive or negative, resulting from the operation of the cashout mechanism under Rate Schedule LMS-MA. Accordingly, there is no basis to modify the amounts to be refunded to include interest. Rehearing is granted on this issue.

III. Tennessee's Refund Compliance Proposal

A. Background

43. In the December 19, 2002 Order, the Commission directed Tennessee to file, within 30 days of the order, a refund plan meeting the following requirements:

OBA operators who are within a zero to five percent imbalance or 1,000 Dth, as outlined in the LMS rate schedules,²⁵ would be classified as non-offending parties eligible for refunds. Non-offending OBA point operators would be determined on a monthly basis.²⁶ The monthly volumes of the non-offending point operators (both receipt and delivery points) will be accumulated for each applicable twelve month period. A pro rata allocation factor to refund the over collection should be determined on the cumulative volumes from non-offending OBA point operators. The net cash out revenues after crediting the VTCA, if any, should be distributed not less than on an annual basis, with interest as set forth in Section 154.501(d) of the Commission's regulations.²⁷

²⁵Tennessee Gas Pipeline Company, FERC Gas Tariff Fifth Revised Volume No. 1, Fifth Revised Sheet No. 208 and First Revised Sheet No. 215B.

²⁶Under this method, the OBA Point Operator may be an offending party in one month and, therefore, the volumes attributable to that balancing party for that month would be excluded from the cumulative volumes for purposes of the calculation of that OBA Point Operator's refund.

²⁷101 FERC ¶ 61,303 at P 28.

B. Compliance Filing

44. On January 21, 2003, Tennessee filed to comply with the December 19, 2002 Order. In its compliance filing, Tennessee proposes to refund the net cashout gain monies, after fulfilling the Cosmic Settlement obligations, to parties that are subject to the cashout provisions of the LMS-MA and LMS-PA rate schedules who fall within a zero to five percent imbalance or 1,000 Dth of volumes. Tennessee provides that the refunds shall be calculated on a monthly basis during the cashout period, based on the cumulative absolute values of non-offending cashouts, to be allocated pro rata no less than annually.²⁸ In its transmittal letter to the filing, Tennessee states that the revised tariff sheet would:

reflect the refund method discussed in the December 19 Order . . . with the clarification that parties who are eligible for the refund include all parties from whom ‘the money originated,’ including point operators and other parties under Rate Schedules LMS-MA and LMS-PA who are the subject to cashout. Specifically, the tariff language provides that upon termination of the Market Area or Supply Area Volumetric Surcharge, that portion of any cumulative positive cashout balance that would have been credited to the VTCA, shall be refunded by Tennessee to parties that are subject to the cashout provisions of the LMS-MA and LMS-PA rate schedules, provided such parties are within a zero to five percent imbalance or 1,000 Dth of volumes on a monthly basis for the months that comprised the applicable cashout period (‘Non-Offending Parties’). In determining whether a Non-Offending Party is within the zero to five percent tolerance, Tennessee will calculate the imbalance percentage using the lesser of the monthly imbalance based on Operational Data or the actual monthly imbalance consistent with Section 7(c) of Rate Schedule LMS-MA. In addition, the absolute value of the monthly cashout volumes for all Non-Offending Parties will be accumulated for the applicable cashout period and a pro rata allocation factor based upon the cumulative volumes will be applied to the total amount to be refunded to determine the amount to be refunded to each party. Further, Tennessee shall include a schedule supporting the allocation of refund to each party with its Annual Cashout Report.

²⁸Tennessee’s FERC Gas Tariff, Fifth Revised Volume No. 1, Sixth Revised Sheet No. 209A.

45. Specifically, the revised tariff sheet would provide:

Upon termination of the Market Area or Supply Area Volumetric Surcharge, that portion of any cumulative positive cashout balance which would have been credited to the VTCA pursuant to Section 3.3 of Article XXV, shall be refunded by Transporter to parties who are subject to the cashout provisions of Rate Schedules LMS-MA and LMS-PA, provided that such parties were within a zero to five percent imbalance (as calculated according to Section 7(c) of this Rate Schedule) or 1,000 Dth of volumes on a monthly basis for the months that comprised the applicable cashout period (“Non-Offending Parties”). The absolute value of the monthly cashout volumes for all Non-Offending Parties will be accumulated for the applicable cashout period and pro rata allocation factor based upon the cumulative volumes will be applied to the total amount to be refunded to determine the amount to be refunded to each party. When the refunds are to be made, Transporter shall include in the Annual Cashout Report a schedule supporting the allocation of refunds to each party.

IV. Notice, Interventions, Protests and Comments

46. Notice of Tennessee's January 21, 2003 compliance filing was issued on January 24, 2003, with comments and protests due on or before January 31, 2003. On January 28, 2003, the Tennessee Municipal Group²⁹ filed to intervene out-of-time in these proceedings.

47. The late-filed intervention will be granted. Granting late intervention at this stage of the proceeding will not disrupt this proceeding or place additional burdens on existing parties as the late intervenor must accept the record as it stands. Several parties³⁰ filed

²⁹ The Tennessee Municipal Group consists of: Cities of Clarksville, Springfield, Portland, and Waynesboro, Tennessee, Corinth Public Utilities Commission, Mississippi, West Tennessee Public Utility District, Greater Dickson Gas Authority, Tennessee, and the Humphreys County Utility District, Tennessee.

³⁰ National Fuel, PSEG, KeySpan, and Louisville Gas and Electric Company (Louisville).

protests to Tennessee's compliance filing, along with motions to reject or suspend the compliance filing.³¹

48. In its protest, Louisville states that the December 19, 2002 Order directed Tennessee to refund solely to the OBA Point Operators, yet Tennessee's compliance filing distributes the revenues solely on cashout activity. Louisville states that there are a variety of mechanisms customers use to stay in balance under the LMS rate schedules, such as daily balancing, swing on storage, trading of imbalances, obligations for customers to adjust nominations and to stay in balance, and if these fail, then cashout. Louisville argues that limiting the refunds to one component of LMS service such as cashout activity (by refunding based on cashout volumes), unfairly discriminates against other LMS customers that use mechanisms other than cashouts to balance their receipts. Louisville states that all LMS customers should be eligible for refund.

49. As clarified in the preceding discussion, we agree with Louisville that this was our intent. Exclusive use of the term "point operators" was for simplification purposes and was not meant to exclude other eligible parties.

50. Louisville protests that the December 19, 2002 Order does not direct that refunds be made based only on cashout imbalance volumes, nor does Tennessee explain or justify its reasoning to base refunds on imbalance volumes. Louisville further states that Tennessee's proposed method to refund based on imbalance volumes is against Commission policy. Louisville and KeySpan state that giving refunds based on imbalance volumes would perversely reward those parties out of balance yet within the acceptable 5 percent bandwidth. Louisville recommends that refunds be based on the total gas flowing through each Balancing Party's meters, rather than imbalance volumes. Alternatively, KeySpan states that Tennessee's method conflicts with the December 19, 2002 Order, in which the Commission required Tennessee to allocate on the basis of total monthly volumes of non-offending receipt and delivery point operators, not on the basis of total monthly imbalance quantities. KeySpan states that, in addition, Tennessee's method fails to encourage shippers to stay in balance.³²

³¹ National Fuel filed an answer to the protest of KeySpan. Although answers to protests are not permitted by Rule 213(a)(2), 18 C.F.R. § 385.213(a)(2) (2003), we will waive the Rule and accept the answer as it may aid the Commission in the disposition of the issues raised by Tennessee's filing.

³² KeySpan Protest at 3-4.

51. As previously addressed in the rehearing section of this order, refunds should be recalculated based on total commodity volumes each month. Accordingly, Tennessee's filing does not comply with the December 19, 2002 Order and must be refiled.

52. PSEG states that the Commission should reject Tennessee's proposal to not pay interest on the refunds due on cashout gains. PSEG states that this equates to an attempt to pocket the time value of monies that Tennessee has had the ability to collect since October 31, 2001. We have granted rehearing on this issue and Tennessee is not required to include interest on the amounts to be refunded.

53. Finally, National Fuel states its concern that if the December 19, 2002 Order is reversed, Tennessee may not be able to fund the revised allocation from a surcharge of the parties who benefited from the December 19, 2002 Order. It asserts that since the great majority of the refunds will be to balancing parties who do not purchase transportation from Tennessee and, thus, do not necessarily have ongoing business with Tennessee that Tennessee could surcharge. Accordingly, it requests that the Commission delay action on refunds until it acts on rehearing.³³ National Fuel's request is moot as we have not acted on the compliance filing until now and are rejecting it with a direction to be refiled in compliance with this order.

54. We find Tennessee's filing does not comply with the December 19, 2002 Order as clarified and modified herein, and direct Tennessee to make the changes as discussed in the body of this order and refile its refund plan within 30 days of the date of this order.

The Commission orders:

(A) Tennessee's compliance filing is rejected and Tennessee must refile within 30 days of this order a modified cashout refund plan in compliance with the directives of this order.

(B) Except to the extent granted, as discussed above, the requests for rehearing are denied.

³³ National Fuel Protest at 2-4.

(C) The requests for clarification are granted or denied, as discussed in the body of this order.

By the Commission.

(S E A L)

Linda Mitry,
Acting Secretary.