UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Tennessee Gas Pipeline Company — Docket No. RP04-138-000

ORDER REJECTING TARIFF SHEET

(Issued February 11, 2004)

1. On January 6, 2004, Tennessee Gas Pipeline Company (Tennessee) filed a revised tariff sheet[1] to implement changes to the capacity release provisions of the General Terms and Conditions (GT&C) of its tariff. The Commission rejects the tariff sheet finding that Tennessee's proposal is not consistent with Commission policy.

I. Description of Filing

2. Tennessee proposes to revise its tariff to permit it to terminate a replacement shipper's agreement if the releasing shipper's agreement has, or will be, terminated. Specifically, Tennessee proposes to add a new Section 11.11(p) to its GT&C:

> Upon written notice to Replacement Shipper that Releasing Shipper's contract has been or will be terminated, Transporter may elect to subject Replacement Shipper's Agreement to an open season. If Transporter makes such election, Replacement Shipper may then elect by written notice within five (5) days to Transporter (1) to terminate its Agreement with Transporter or (2) to enter into a pre-arranged transaction for the capacity in an open season held pursuant to Article XXVIII, Section 5 of the General Terms and Conditions at the lesser of the Releasing Shipper's contract rate or the maximum applicable tariff rate, or a mutually agreed upon rate. If the Replacement Shipper elects to participate in an open season, then

[1] Original Sheet No. 339C to FERC Gas Tariff, Fifth Revised Volume No. 1.

> Replacement Shipper shall have the same matching rights as those provided in Article XXVIII, Section 5.9.[2]

3. Tennessee states that while the Commission's policy generally requires a pipeline to give a replacement shipper the option of paying the lower of: (1) the releasing shipper's contract rate; or (2) the maximum tariff rate for the remainder of the replacement shipper's contract before a pipeline can undertake to terminate the temporary release, the policy requires modification to account for Tennessee's tariff requirement to award generally available long-term capacity, including capacity made available by the expiration of an existing contract, under an open season. Tennessee states that the open season approach is just and reasonable and will serve to facilitate the Commission's goal that shippers who value capacity the most should have a fair opportunity to contract for capacity. Tennessee also states that the replacement shipper will be protected since its agreement would be a prearranged deal in accordance with Article XXVIII, Section 5.9 of its tariff. While this "prearranged deal" would be posted so that third parties could submit bids for the capacity with a higher net present value (NPV), the replacement shipper would have the right to match any bid with a higher Net Present Value (NPV) and retain its capacity.

II. <u>Public Notice & Interventions</u>

4. Public notice of the filing was issued on January 13, 2004, with interventions and comments due as provided in Section 154.210 of the Commission's regulations. Pursuant to Rule 214 (18 C.F.R. § 385.214 (2003)), all timely filed motions to intervene and any motions to intervene out-of-time filed before the issuance date of this order are granted. Granting late intervention at this stage of the proceeding will not disrupt the proceeding or place additional burdens on existing parties.

5. Protests were filed by the following parties: Calpine Energy Services, L.P. (Calpine); Rhode Island State Energy Statutory Trust 2000 (the Trust); Indicated Shippers; Tenaska Marketing Ventures (Tenaska); the Process Gas Consumers Group (PGC); Consolidated Edison Company of New York, Inc. and Orange and Rockland Utilities, Inc. (collectively ConEd); Duke Energy Marketing America, L.L.C. and Duke

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[2] Section 5.9 of Article XXVIII "Pre-Arranged Deals" provides, among other things, that if a party submits a bid with a higher NPV to Transporter for the pre-arranged capacity, the customer with the pre-arranged transaction will have a one-time right within 48 hours of notification to match the higher bid's NPV in order to obtain the capacity. <u>See</u>, First Revised Sheet No. 405E to FERC Gas Tariff, Fifth Revised Volume No. 1.

Energy Trading and Marketing, L.L.C. (collectively, Duke Energy); and Reliant Energy Services, Inc. (Reliant).

6. The protestors request that the Commission either reject Tennessee's proposal or accept the tariff language subject to modifications so that it conforms to Commission policy. However, in the event that the Commission does not reject the proposal outright, the Trust requests that the Commission suspend the filing for the maximum applicable period and set the filing for a technical conference where the issues can be vetted fully.

III. Protests

7. Calpine, the Trust, Indicated Shippers, Tenaska, PGC and Con Ed object to Tennessee's unilateral right to terminate a replacement shipper's contract and subject the replacement shipper's capacity to an open season with the winning bids evaluated on a NPV basis. The protestors argue that Tennessee's proposal would not grant the replacement shipper the protections as established in Tenaska Marketing Ventures v. Northern Border Pipeline Company (Tenaska)[3] and Northern Border Pipeline Company (Northern Border).[4] The protestors argue that the Commission found in Tenaska that a replacement shipper has a contractual relationship with the pipeline that is independent of the releasing shipper's contract, and that the releasing shipper's contract does not automatically terminate or give the pipeline the automatic right to terminate the replacement shipper's contract. The protestors state that the Commission further found in Northern Border, that the pipeline must, prior to the termination of the replacement shipper's contract, offer to continue to provide service to the replacement shipper since the pipeline does not have an unqualified, unilateral right to terminate service to the replacement shipper. The parties argue that Tennessee's proposal fails to comply with the Commission's finding in Northern Border that the pipeline must give the replacement shipper the option of paying the lower of (1) the former releasing shipper's contract rate, or (2) the maximum tariff rate for the service for the remainder of the replacement shipper's contract.

8. The protestors also argue that Tennessee's proposal provides it too much discretion in that Tennessee "may elect" to subject the replacement shipper's agreement to an open season. Specifically, the protestors contend that the Tenaska decision would find Tennessee's proposal to be unduly discriminatory since it would allow Tennessee the unilateral choice of continually locking in replacement shippers' contracts when the market is soft or terminating the contracts when Tennessee could get a higher rate in an

[3] 99 FERC ¶ 61,182 at 61,709 (2002).

[4] 100 FERC ¶ 61,125 (2002).

open season. Con Ed argues that Tennessee's proposal is not just and reasonable since under Tennessee's approach, when capacity is not in demand, it will not elect the open season and the replacement shipper will keep its contract in place. In contrast, when Tennessee's capacity is in demand, Tennessee will elect the open season approach with the objective of maximizing its profits. Similarly, Duke Energy argues that Tennessee's proposal to subject replacement shipper contracts to its open season procedures is actually an effort to circumvent the Tenaska policy and enable Tennessee to capture additional revenues in circumstances where the market price of the replacement shipper's capacity has increased over the rate specified in the releasing shipper's contract.

9. Calpine, Tenaska, PGC, the Trust and Reliant argue that Tennessee's proposal would result in uncertainty in the capacity release market since a replacement shipper could not rely on its contract. The protestors argue that Tennessee's proposal would place replacement shippers in a competitive disadvantage since there would be an unacceptable risk involved in entering release transactions that does not exist when purchasing capacity directly from the pipeline. Under Tennessee's proposal, a replacement shipper could have its contracted capacity terminated at any time through no fault of its own and be forced to pay a renewed market price to retain the capacity; whereas, shippers purchasing capacity directly from the pipeline do not have this risk. The parties argue that Tennessee's proposal would upset the Commission's established balance between a pipeline's and a shipper's interest since a replacement shipper would have no certainty with regard to either the price or the term since the replacement shipper may be required to pay more for the capacity than the releasing shipper's rate for an extended period of time in order to match the NPV evaluation set forth in Tennessee's tariff.

IV. Tennessee's Answer

10. On January 29, 2004, Tennessee filed a response to the protests. Rule 213(a)(2) of our Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (1997), prohibits an answer to a protest unless otherwise ordered by the decisional authority. We find that Tennessee's answer aids us in addressing the issues raised by the protests, and we will therefore, accept its answer.

11. Tennessee states that the proper standard in evaluating the proposed tariff revision is whether the tariff language is just and reasonable and not whether a proposal would bring added value to the pipeline. Tennessee holds that its open season procedures are a reasonable method for awarding generally available long term capacity. This serves the Commission's goal that shippers who value capacity should have the opportunity to contract for capacity.

12. Tennessee agrees with the protestors that Tenaska and Northern Border establish the principle that a pipeline's revenue neutrality is a proper balance between a

replacement shipper and the pipeline when the releasing shipper's contract has been cancelled. However, Tennessee argues that revenue neutrality requires the rate and term of the replacement shipper's contract be considered. For example Tennessee states, if it (1) contracts with a releasing shipper for a ten year term at a discounted rate; then (2) the releasing shipper contracts with a replacement shipper for a two year term at a further discounted rate; and then (3) one year later the releasing shipper's contract is terminated; Tennessee is not left revenue neutral since Tennessee agreed to the discounted rate with the releasing shipper based on the ten year term and not the two year or remaining one year term. Tennessee argues that the same discounted rate at the shorter term does not yield Tennessee the same NPV. Therefore, since the releasing shipper won the capacity based on the NPV for the longer term, requiring Tennessee to accept that same rate for a shorter term is neither just nor reasonable.

13. Finally, Tennessee also states the replacement shipper's interests will be adequately protected since the replacement shipper will have the right to match any competing bid and Tennessee would be required to accept the replacement shipper's matching bid. Furthermore, Tennessee argues that holding an open season in this situation supports the Commission's goal of an open and competitive capacity market where the marketplace sets the value on the capacity and that these risks are inherent in today's release market. Tennessee would require a longer term only if the market demands such.

V. Discussion

14. The Commission finds that Tennessee's proposal does not comport to the policy set forth in Tenaska and Northern Border. Contrary to Tennessee's proposal, there is privity of contract between the pipeline and replacement shipper, since a capacity release is implemented by the replacement shipper entering into a service agreement directly with the pipeline. The termination of the releasing shipper's contract therefore does not terminate the replacement shipper's contract. Consequently, the replacement shipper's capacity does not become generally available capacity subject to the posting requirements of Tennessee's tariff, until the replacement shipper's contract expires.

15. There may be circumstances where the pipeline could have a legitimate reason to want to terminate a capacity release arrangement if the primary shipper's contract were terminated. For example, the Commission has reasoned that in a capacity release transaction, the pipeline does not establish the price or terms and conditions of the release, and therefore could want to terminate the arrangement if the replacement shipper were paying a rate lower than the rate paid under the releasing shipper's terminated contract. However, the policy in Northern Border requires the pipeline to permit the replacement shipper to retain its capacity by agreeing to pay the lower of: (1) the former

releasing shipper's contract rate; or (2) the maximum tariff rate for the service for the remainder of the replacement shipper's contract.[5] This policy balances the interests of the replacement shipper and the pipeline. It provides the replacement shipper an opportunity to retain its capacity upon the termination of a releasing shipper's contract, while also permitting the pipeline to continue to collect the same revenue, up to the maximum just and reasonable rate, it would have collected from the releasing shipper for the remaining term of the replacement shipper's contract.

16. The Commission has held that, if the pipeline terminates the releasing shipper's contract, it need not post the capacity for an auction as a means of giving the replacement shipper an opportunity to obtain a lower rate than that in the releasing shipper's contract, where the market value of the capacity has declined since the pipeline entered into its contract with the releasing shipper.[6] By the same token, the Commission sees no reason to permit the pipeline to post the capacity in order to obtain a higher rate than it may have agreed to in a discounted rate contract with the releasing shipper. The Commission recognizes Tennessee's concern that the replacement shipper's contract may be for a shorter term than the releasing shipper's discounted rate contract. In that circumstance, when the replacement shipper's contract expires, Tennessee will have an opportunity to post the capacity in order to seek a higher rate. However, in the meantime, the Commission believes the replacement shipper's interest in retaining its capacity outweighs any interest Tennessee may have in seeking greater revenue from the sale of the capacity than that which it had already limited itself to in its discounted rate contract with the releasing shipper.

[5] The policy was further revised to provide that a lower rate could be mutually agreed to by the pipeline and replacement shipper. See, e.g., Texas Eastern Transmission, LP, 101 FERC ¶ 61,071 (2002); Columbia Gas Transmission Corporation, 101 FERC ¶ 61,179 (2002); and ANR Pipeline Company, 102 FERC ¶ 61,031 (2003).

[6] See, e.g., Natural Gas Pipeline Company of America, 100 FERC ¶ 61,269 at 62,026 (2002); Northern Border Pipeline Company, 100 FERC ¶ 61,125 (2002); Canyon Creek Compression Company, 100 FERC ¶ 61,283 (2002); Kinder Morgan Interstate Gas Transmission LLC, 100 FERC ¶ 61,366 (2002); and Texas Eastern Texas Eastern Transmission, LP, 101 FERC ¶ 61,071 (2002).

<u>The Commission orders:</u>

Tennessee's tariff proposal is rejected, as discussed in the body of this order.

By the Commission.

(S E A L)

Linda Mitry,
Acting Secretary.