122 FERC ¶ 61,191
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Colorado Interstate Gas Company — Docket Nos. RP07-666-000, RP07-667-000

ORDER FOLLOWING TECHNICAL CONFERENCE

(Issued February 29, 2008)

1. On August 31, 2007, in Docket No. RP07-666-000, Colorado Interstate Gas Company (CIG) filed tariff sheets[1] to revise its lost, unaccounted for and other fuel gas (collectively, LUF) tracking mechanism and, in Docket No. RP07-667-000, a tariff sheet[2] to update the calculation of its cash-out Index Price and cash-out System Index Price (collectively, cash-out prices). On September 27, 2007, the Commission issued an order[3] accepting and suspending the tariff sheets, to become effective March 1, 2008, subject to a technical conference established to address the issues raised by CIG's filings. The technical conference was held on November 15, 2007. Based on further review of the filings and comments on the technical conference, the Commission conditionally accepts CIG's tariff sheets filed in Docket No. RP07-666-000 effective March 1, 2008 and rejects CIG's tariff sheet filed in Docket No. RP07-667-000, as discussed below.

[1] First Revised Sheet No. 380K, Second Revised Sheet No. 380L and Original Sheet No. 380L.01 to its FERC Gas Tariff, First Revised Volume No. 1.

[2] Third Revised Sheet No. 229A.01 to its FERC Gas Tariff, First Revised Volume No. 1.

[3] *Colorado Interstate Gas Co.*, 120 FERC ¶ 61,287 (2007).

I. Docket No. RP07-666-000

A. Background

2. CIG's existing tariff allows CIG to collect transportation fuel gas and LUF from its customers through in-kind reimbursement percentages, which CIG files with the Commission on an annual basis and on a quarterly basis, respectively. To ensure that these reimbursement percentages do not lead to over- or under-recoveries, CIG's existing tariff provides for volumetric (i.e., gas in-kind) true-ups, which adjust the reimbursement percentages to reflect CIG's actual over/under-collected fuel and LUF.

3. In CIG's August 31, 2007 filing in Docket No. RP07-666-000, CIG proposed to "monetize" its true-up mechanism for LUF to track the changes in financial value in addition to the volumetric tracking of gas quantities used and retained (i.e., an "economic true-up"). In addition, CIG proposes to broaden its LUF mechanism to include the net cost or revenue related to gas balancing activities. CIG states that, because the impact of gas balancing activity is system-wide, it will include the true-up of costs and revenues arising from gas balancing as part of the LUF reimbursement on receipt quantities for all transactions, and will not attempt to attribute such costs and revenues to specific transactions.

4. CIG argues that under-collected (or over-collected) quantities affect the overall gas balance of its system and must come from purchases, or be taken from linepack, operational balancing agreements or storage. It states that each of these activities are conducted in the normal course of business to the benefit of all shippers and that the over- or under-collection of fuel and related gas balance items have both a volume and dollar impact on all shippers. CIG acknowledges that the cost of service related to base storage gas and capitalized linepack is reflected in its base transportation rates, but that when these assets vary (i.e., by CIG's having to take gas from storage or linepack to correct imbalances) the costs of such "encroachments" are not reflected in the base rates.[4]

5. CIG gives strong assurance that the workpapers supporting each use of its expanded recovery mechanism will fully detail all sources and distributions of gas,

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[4] CIG states that to calculate the components of the sources and distributions of fuel and gas balance-related activity as a dollar value it will use the actual amounts it paid or received to purchase or sell gas and multiply the over- or under-recovered volume due to shipper imbalances by the appropriate cash-out Index Price for the month the activity occurred. In addition, CIG states that when converting the total annual cost or revenue adjustment amount to a volumetric quantity to be included in the LUF reimbursement percentage it will divide the sum of the monthly dollar values by the average cash-out Index Price for the entire data collection period to generate a volume that is equivalent to the cost or revenue impact of the total gas balance related items.

including fuel gas and LUF, and any operational gas "encroachment" over/under recovery, and that any financial impacts of that mechanism will be credited to shippers and/or charged to shippers as a true-up in subsequent LUF recovery filings in a transparent and understandable manner. Additionally, while CIG currently adjusts its base LUF percentage on a quarterly basis, the cost and revenue true-up adjustment will be adjusted annually at the same time the volumetric true-up and the fuel gas percentages are adjusted.

6. On September 12, 2007, Williams Power Company, Inc. (Williams) filed a protest and request to consolidate dockets primarily arguing that CIG's proposal to collect system balancing costs from all customers regardless of whether or not they incurred an imbalance or contributed to the loss is an inappropriate cross-subsidization that should be rejected. Indicated Shippers[5] also filed a protest arguing that CIG's proposed mechanism is too complicated and includes costs that are already included in CIG's existing rates. They argued that CIG's proposed mechanism along with its proposed changes to its cash-out pricing methodologies in Docket No. RP07-667-000 will result in CIG over-recovering its replacement gas costs. Indicated Shippers therefore request that the Commission reject the expansion and monetization of CIG's existing LUF mechanism.

B. <u>Comments Following Technical Conference</u>

7. CIG, Williams, Indicated Shippers, and Anadarko Petroleum Corporation (Anadarko) filed initial comments and reply comments and Public Service Company of Colorado (PSCo) filed reply comments. In addition, CIG filed an answer to William's reply comments, an errata to its own reply comments, and supplemental comments on January 24, 2008, January 25, 2008 and February 8, 2008.[6]

1. <u>Initial Comments</u>

8. In its initial comments, CIG emphasizes that the purpose of its proposal is to keep CIG and its shippers revenue neutral, and that any over-recoveries due to the timing of operational sales and purchases would be returned to shippers through the use of what CIG calls "vintage accounting." CIG explains that in each true-up filing, CIG will demonstrate whether the intended cost or revenue amount was collected through the LUF reimbursement percentage and CIG will readjust the percentage as necessary in future

[5] The Indicated Shippers are BP Energy Company, BP America Production Company, and Marathon Oil Company.

[6] CIG's answer included a correction to a typographical error in an attachment to its original comments and a response to an argument Williams made in its reply comments. CIG's errata filing corrected a typographical error in CIG's reply comments and CIG's supplemental comments include a correction to a workpaper.

periods to ensure no over-recovery occurs. CIG states that this process, as demonstrated in Appendix B of its comments, is similar to the process the Commission used to review pipelines' purchased gas adjustment filings during the merchant sales era to make sure that an over-recovery of gas costs did not occur.

9. In addition, CIG argues that its proposal is just and reasonable because it only seeks to recover legitimate costs of doing business, not otherwise reflected in its rates. CIG states that, without its proposal, when a shipper engages in imbalance activity that drafts[7] CIG's linepack or reduces CIG's retained storage or when CIG's linepack or storage are reduced due to lost and unaccounted for volumes, the difference between the cost of replacing linepack or storage and the original cost would be an over- or under-recovery for CIG (depending on whether the replacement cost is higher or lower than the original gas cost). CIG also argues that it is impossible to trace the cause of a particular operational purchase or sale to any distinct event; therefore it is appropriate to track these encroachment costs in the LUF tracking mechanism and recover them from all shippers on its system.

10. Further, CIG states that its proposal is materially the same as a monetized tracking mechanism proposal the Commission accepted in *El Paso Natural Gas Co.*,[8] which encompasses both fuel-related losses and other operational impacts. In *El Paso*, CIG's affiliate pipeline proposed a tracking mechanism that included the costs associated with fuel and LUF, and the financial impact of gas acquisition and disposition (including the financial impact of linepack and other system gas balance items such as cashout and imbalance activity). CIG notes that a non-material difference between its proposal and the one accepted by the Commission in *El Paso* is that El Paso proposed to track the financial impact of gas balance items in its mainline fuel reimbursement percentage, whereas CIG has proposed to do so through its LUF reimbursement percentage. CIG reasons that the two tracking mechanisms are materially the same because both track the economic impact of all fuel, lost and unaccounted for gas, and gas balance items. CIG states that if the Commission approves its proposal CIG will make annual filings that are lucid and clear and that contain the same level of detail the Commission required in *El Paso*.

11. In their initial comments, the Indicated Shippers argue that the system operational costs and linepack costs CIG proposes to include in its fuel tracking mechanism are already covered in CIG's existing rates as established in the black box settlement in

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

[8] 117 FERC ¶ 61,361 (2006), *order on compliance filing,* 120 FERC ¶ 61,152 (2007) (*El Paso*).

CIG's most recent rate case proceeding.[9] Thus, Indicated Shippers assert, recovery of these costs through CIG's fuel tracking mechanism would amount to a double recovery. Alternatively, Indicated Shippers argue that if the Commission does not find these costs to be embedded in CIG's existing rates, the Commission should find that CIG's proposal is subject to the rate moratorium established under the black box settlement.

12. Indicated Shippers next argue that CIG's proposed monetization of system costs would disrupt commercial transactions and that by introducing price volatility into the heretofore in-kind transactions, CIG's proposal would immerse CIG in a gas merchant function. Furthermore, Indicated Shippers argue, CIG's proposal improperly socializes costs by allocating them by throughput, instead of by shipper responsibility, violating the requirement that cost incurrence match cost responsibility. Also, Indicated Shippers state that the inclusion of operational balancing agreement (OBA) costs is inappropriate because such costs are already allocated pursuant to the terms of the OBAs.

13. Additionally, Indicated Shippers argue that fuel exempt transactions (i.e., backhaul transactions) should not be subject to fuel reimbursement charges and that allocation factors exist that can be used to reasonably approximate the portion of system operating costs not associated with fuel. Finally, Indicated Shippers note that the storage fuel rate mechanism in CIG's tariff does not expressly include an LUF component and argue that the Commission should require CIG, under section 5 of the Natural Gas Act (NGA), to allocate storage LUF to transportation shippers in proportion to the extent that CIG reserves storage to support transportation service.

14. Like Indicated Shippers, Williams expresses concern that CIG's proposal will inappropriately assess fuel-related charges on backhaul transactions. In addition, Williams asserts that the "illustrative" workpapers supporting CIG's proposal are deficient because they do not use actual data and they do not show the calculations of the LUF reimbursement percentage adjustment. Based on Williams' analysis of 2006-2007 operational purchases and sales data CIG reported to the Commission,[10] Williams argues that CIG has not been exposed to substantial costs related to its operational purchases and that, for the previous year, CIG's imbalance cash-out sales and purchases were the same amount, thereby netting each other out. However, Williams states that because CIG was able to sell imbalances at a cash-out price higher than it purchased imbalances, the effect of CIG's proposed tracking mechanism would be to provide it with a positive cash flow. Williams notes that the combination of CIG's lower purchase costs and lower imbalance cash-out purchase costs produce a $2.8 million over-collection by CIG.

[9] Indicated Shippers, Initial Comments at 2 (citing *Colorado Interstate Gas Co.*, 116 FERC ¶ 61,126 (2006) (approving uncontested settlement of rate case)).

[10] Colorado Interstate Gas Co., September 29, 2007 Filing, Docket No. RP08-8-000.

15. Furthermore, Williams states that CIG's proposal creates a significant risk of intergenerational cross-subsidies spanning multiple periods. Williams argues that CIG's proposed vintaging process will result in perpetual changes to the LUF reimbursement percentage, and may interminably postpone proper reimbursement.

16. In addition, Williams states that because CIG's LUF reimbursement percentage cannot fall below zero,[11] CIG's proposal will result in dramatic over-recoveries that can only be addressed through cash refunds to shippers, which CIG's proposal does not address. Williams also states that CIG's proposed economic true-up will inevitably create volumetric imbalances as a result of CIG's conversion of economic value credits or charges into volumetric amounts which will force CIG into the gas market more and more frequently. Williams objects to CIG's assertions that its system gas balance activities cannot be separately identified. Further, Williams raises concerns as to how CIG will credit processing revenues to shippers and asserts that whereas the prudence of CIG's operational purchases is not an issue under its current tracking mechanism, it will become an issue under CIG's proposed tracking mechanism.

17. Like Indicated Shippers, Anadarko argues that CIG's proposal violates the Commission's policy that cost incurrence be matched with cost responsibility. Anadarko also argues that CIG proposes to inappropriately include gas costs that are neither lost nor unaccounted for in its LUF tracking mechanism.[12] According to Anadarko, CIG's proposal will eliminate CIG's incentive to maximize the value of its purchases and sales, creates additional system imbalances that could require CIG to incur additional fuel costs, and double-recovers CIG's fuel costs.

2. Reply Comments

18. In its reply comments, CIG argues that the protesters place an inordinate amount of focus on imbalances, which are only one factor and that they ignore the central feature of CIG's proposal—that CIG will return any over- or under-collections to its shippers in a completely transparent manner, and with interest as appropriate to make shippers whole. Specifically, CIG states that, in addition to providing the same level of information ultimately accepted in *El Paso*, it is willing to accept other reasonable conditions including providing interest on any refunds that cannot be flow back through its LUF reimbursement percentage in any particular year.

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[11] Colorado Interstate Gas Company, FERC Gas Tariff, First Revised Vol. No. 1, First Revised Sheet No. 380L ("Neither the Fuel Gas reimbursement percentage nor the Lost, Unaccounted For and Other Fuel Gas retention percentage may be less than zero.").

[12] Anadarko, Initial Comments at 5 (*citing Colorado Interstate Gas Co.*, 121 FERC ¶ 61,161 (2007)).

19. CIG also argues that Williams' analysis applies future cash-out pricing data from CIG's proposal in Docket No. RP07-667-000 to historical data, which CIG itself chose not to include in its workpapers because it felt that these data were unrepresentative of the future. Further, CIG states that Williams' analysis exaggerates any potential over-collection because it does not take into account the fact that to avoid penalties such as those CIG proposed to increase in Docket No. RP07-667-000, shippers will respond by reducing their imbalances on CIG's system.

20. CIG refutes Williams' objection that the economic true-up will lead to perpetual change in the monetized LUF reimbursement percentage by pointing out that the same criticism is applicable to a volumetric tracking mechanism for prior period over-/under-collections. CIG agrees with Anadarko that the proposed economic true-up could result in a positive or a negative dollar amount even if there were no required volumetric true-up. CIG, however, uses this fact to support its proposal, arguing that even if the designated fuel reimbursement is equal to fuel burn over the course of a year, fuel reimbursement and actual burn will vary on a daily basis while, simultaneously, gas prices fluctuate. According to CIG, this may create gains if CIG has to make operational sales during high price periods and losses if CIG has to make operational purchases during high price periods. CIG states that this financial volatility is what necessitates the change from an in-kind to an economic true-up.

21. CIG next states that it agrees with the protesters that fuel, LUF and shipper imbalances can be discretely measured and, as shown in its workpapers, it will continue to measure and treat these items separately. CIG argues however that its proposed economic true-up does not hinge on these discrete measurements, but on the fact that the actions underlying CIG's operational purchases and sales that create differences in gas value cannot be traced to individual fuel, LUF or imbalance activities. Thus, CIG argues, because the costs it incurs cannot be traced to individual activities, CIG is not improperly socializing costs, nor is it violating the principle that cost incurrence match cost responsibility. Additionally, CIG disputes the assertion that its proposal will put it in the gas commodity more often, stating that the opposite is just as likely to occur.

22. With regard to Williams' claim that CIG has not accounted for processing revenues in its workpapers, CIG states that processing revenues will continue to be recovered in the same way they are recovered today—as a part of the LUF reimbursement percentage. Finally, CIG argues that the terms of its 2006 rate moratorium do not bar CIG from proposing to change its in-kind LUF to an economic true-up, or to expand the components of its LUF adjustment. Rather, CIG argues that the language of the settlement only barred changes to base tariff rates such as reservation charges, usage charges, and related charges in CIG's tariff.

23. In their reply comments, the Indicated Shippers reiterate many of the arguments they made in their comments. They add that CIG's reliance on *El Paso* is misplaced because the Commission approved El Paso's proposal in the absence of any significant shipper protest, and without any analysis of whether or not monetization of a fuel tracker that includes operational purchases and sales is appropriate.

24. In its reply comments, Williams maintains its objections to the data CIG provided to support its proposal and adds that *El Paso* is inapposite because of differences between the pipelines' systems. Specifically, Williams states that CIG makes most of its operational purchases to support its processing activities, whereas El Paso showed no gas used for processing in its workpapers. Additionally, Williams notes that El Paso tracks the financial impact of gas balance items in its fuel reimbursement percentage whereas CIG intends to use its LUF reimbursement percentage. Williams argues that this is not a non-material difference because it will force backhaul shippers to absorb a fuel-related charge even though they do not use fuel. Furthermore, Williams argues that the impact of CIG's proposal will be much more extreme than the impact of El Paso's proposal and that the economic true-up will overwhelm the LUF reimbursement percentage. Additionally, Williams argues that linepack are included in CIG's rate base and that CIG has sufficient tools to manage imbalances under its current tariff.

25. In its reply comments, Anadarko reiterates its argument that CIG's proposal would inappropriately place balancing costs on all of its shippers, not just those that caused CIG to incur the balancing costs. Anadarko states that CIG has not supported its assertion that such costs cannot be attributable to a single shipper or class of shippers, pointing out that CIG is able to track shippers' imbalances under its cash-out mechanism. Furthermore, Anadarko argues that if CIG cannot attribute costs to a specific cause, it should not be permitted to collect them.

26. PSCo states that it takes no position on the merits of CIG's proposal but that Indicated Shippers' attempt to have the Commission revise CIG's existing LUF mechanism to reduce the allocation of storage LUF to transportation services is beyond the scope of the instant proceeding and should be rejected.

C. Discussion

27. We accept CIG's proposed revision to its LUF tracking mechanism, subject to conditions, as discussed below. As a preliminary matter, we find that CIG's proposal is not barred by the settlement in CIG's most recent rate case.[13] While the parties to the settlement specifically chose to include tariff sheets associated with CIG's base

[13] *See Colorado Interstate Gas Co.*, 116 FERC ¶ 61,126 (2006) (approving uncontested settlement).

transportation rates, they did not address CIG's tracked costs, including the LUF tracking mechanism.[14]

28. Turning to the merits of CIG's proposal, we agree with CIG that the current LUF tracking and true-up mechanism is designed to keep CIG and its shippers volumetrically neutral through the annual and quarterly adjustments to CIG's fuel gas reimbursement percentages. However, the current mechanism does not ensure CIG and its shippers are entirely revenue neutral with regard to the effects of daily activities associated with fuel gas used in CIG operations. We agree with CIG that due to the nature of pipeline operations, there will be daily and monthly volume differences in actual versus collected fuel, even if on average the annual quantity collected is equal to that used. Further, in order to effectively maintain the overall balance on their transmission systems, pipelines must, on a real-time, daily basis, conduct such activities as purchase or sell gas, take or replace linepack or storage gas and work with interconnecting pipelines to maintain balance via operational balancing agreements.

29. The Commission has previously recognized that when a pipeline is permitted to "track changes in a particular cost item without regard to changes in other cost items . . . there should be a guarantee that changes in that cost item are tracked accurately."[15] Here, CIG states that because it currently tracks volumetric but not dollar value differences between actual fuel retained and fuel burned, it bears the risk (downside or upside) associated with volatility in gas prices. Indeed, CIG states that under its current LUF tracking mechanism, it over-recovered $2.8 million in the last calendar year—an over-recovery, that according to CIG would have been returned to its customers under its proposal. Thus, CIG's proposal here should enable it to more accurately track its costs and reflect them in its reimbursement percentages.

30. Further, we note that CIG's proposed tracking mechanism is similar to one the Commission recently accepted in *El Paso*.[16] While there are some differences, as noted above, the essential elements (*i.e*, an economic true-up mechanism that includes system operational balancing costs and revenues) remain the same, and are consistent with the policy established in *ANR* that require tracking mechanisms to accurately track costs. While Indicated Shippers may be correct that there was no extensive discussion of the economic true-up aspect of El Paso's tracking mechanism proposal in the Commission's order accepting the proposal, El Paso's filing was noticed and interested parties had the opportunity to challenge all aspects of El Paso's proposed tracking mechanism, including

[14] *See Colorado Interstate Gas Co.*, June 20, 2006 Stipulation and Agreement, Docket No. RP06-397-000, at 3 and App. B.

[15] *ANR Pipeline Co.*, 110 FERC ¶ 61,069, at P 26 (2005).

[16] *El Paso Natural Gas Co.*, 114 FERC ¶ 61,305, at P 207-08 (2006).

the economic aspects. Accordingly, we find it reasonable, in light of *El Paso* for CIG to propose a similar tracking mechanism.

31. With regard to many of the concerns raised by the commenters, we find them to be unsubstantiated, premature or speculative at this point. For instance, Williams' analysis of the effect of CIG's proposed economic true-up, which led Williams to conclude that CIG would over-collect substantial amounts, does not provide a reasonable picture of the economic true-up on its own (i.e., without the cash-out pricing proposals that we reject below). Furthermore, CIG has stated that to the extent that any over-collection occurs, it will refund such amounts through the LUF reimbursement percentage, or if necessary, through cash refunds including interest. Although challenging the prospect of an over-recovery is premature at this point, we note that interested parties will have the opportunity to challenge the calculation of CIG's actual reimbursement percentages when CIG files the annual update. CIG has also given assurances that its annual update will be fully transparent and understandable. This will require CIG to provide substantial detail with respect to operational purchases and sales for fuel use versus daily operations related to shipper imbalances and service flexibility provided by CIG under its various transportation and storage rate schedules.

32. In addition, Indicated Shippers argue that CIG's operational gas and linepack costs are included in CIG's rate base, and therefore CIG's attempt to recover those costs in its tracking mechanism would lead to a double-recovery. CIG unequivocally states that linepack encroachment costs are not reflected in the base rates. We agree with Indicated Shippers that linepack quantities and values included in CIG's Account No. 117 are included in the rate base underlying CIG's rates. However, CIG's linepack balance as reflected in that Account does not change as a result of this filing. CIG is only proposing to recover costs associated with daily purchases and sales due to shortfalls and over-recoveries of compressor fuel. The underlying linepack balance in Account No. 117 will remain the same. Accordingly, we reject Indicated Shippers' arguments.

33. We also reject protesters' arguments requesting that backhaul shippers be exempt from CIG's monetized LUF mechanism because they do not use fuel. CIG is required to make operational sales and purchases to maintain system operation for all shippers on the pipeline system. Moreover, every shipper on the system contributes to the need for CIG to make operational gas purchases, the costs of which are reflected in CIG's new LUF mechanism. The Commission's general policy is that all shippers pay fuel charges, including lost and unaccounted for. Pipelines may exempt shippers from fuel charges for transactions that do not use fuel; however, pipelines may not exempt shippers from lost and unaccounted for charges.[17]

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[17] *See, e.g., Northern Natural Gas Pipeline*, 119 FERC ¶ 61,278, at P 13-14 (2007); *Colorado Interstate Gas Co.*, 112 FERC ¶ 61,199 (2005); *Mississippi River Transmission Corp.*, 98 FERC ¶ 61,119, at 61,353 (2002).

34. Protesters also argue that monetization of the operational costs in CIG's fuel tracking mechanism is inappropriate because it would introduce price volatility into shipper transactions and it would transform CIG's tracking mechanism into a gas market hedging platform for the pipeline. However, under the existing tariff, CIG still needs to purchase and sell gas for operational purposes. Its LUF tracking mechanism is designed to track and true-up fuel costs. CIG has shown how its current mechanism may produce inaccurate results. CIG's proposal requires that it remain revenue neutral in its purchases and sales of operational gas. To this end, we note that CIG is already required to report these purchases and sales,[18] and must do so in a fully transparent manner. Thus, shippers will have an opportunity to review CIG's purchases and sales to ensure that they they were made for system operational purposes. We note that the protesters have generally argued that CIG does not need to make this change to its true-up mechanism and that they are satisfied with the current mechanism. However, for the reasons stated above we find CIG's proposal to be just and reasonable.[19]

35. Therefore, we accept CIG's proposed tracking mechanism, subject to the following conditions. First, to ensure transparency in the costs and revenues that will be recovered through the revised LUF tracking mechanism, CIG is required to establish and maintain sub-accounts 117.2 (System Balancing Gas) and 117.4 (Gas Owed to System Gas) as defined under Part 201 of the Commission's Regulations.[20] Second, in the event that CIG cannot flow through an over-collection in a given year because of the limits of its LUF reimbursement percentage, CIG will be required to provide cash or invoice credit refunds to its customers, including interest at the Commission's interest rate specified under section 35.19(a)(2)(iii) of the Commission's Rules and Regulations,[21] from the time of CIG's annual filing until the time such refunds are made. Finally, CIG must file annual updates that fully document purchases and sales of fuel gas volumes, and that distinguish purchases and sales for system balancing purposes and, if any, for providing flexibility under its various services. Such descriptions and workpapers must be sufficiently transparent to permit adequate review of activity under this true-up mechanism.

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[18] *See Colorado Interstate Gas Co.*, 107 FERC ¶ 61,312, at P 14-15 (2004).

[19] *See Wisconsin Public Power, Inc. v. FERC,* 493 F.3d 239, 266 (D.C. Cir. 2007) ("Merely because petitioners can conceive of a refund allocation method that they believe would be superior to the one FERC approved does not mean that FERC erred in concluding the latter was just and reasonable. Again, reasonableness is a zone, not a pinpoint.").

[20] 18 C.F.R. Part 201 (2007).

[21] 18 C.F.R. § 35.19(a)(2)(iii) (2007).

II. Docket No. <u>RP07-667-000</u>

A. <u>Cash-out System Index Price</u>

1. <u>Background</u>

36. Under CIG's existing tariff, the cash-out System Index Price, which CIG primarily uses to cash out shipper net monthly imbalances by applying a market-related rate to end-of-month imbalances, is defined as the average weekly price among the North and South reporting points over a five-week period.[22] CIG applies the highest North/South weekly average to cash out gas quantities that shippers owe to CIG and the lowest North/South weekly average to cash out quantities that CIG owes to shippers.

37. In its August 31, 2007 filing in Docket No. RP07-667-000, CIG proposes to revise the method for determining the System Index Price so that instead of combining the weekly average prices at the North *and* South reporting points, CIG will use the higher or lower weekly average price at the North *or* South reporting point. Thus, under CIG's proposal, if shippers owe gas to CIG, either because of shipper under-deliveries or a failure to return loaned gas, the System Index Price will be the highest of the weekly averages from either the North or South pricing points; if CIG owes gas to a shipper, however, the System Index Price will be the lowest of the weekly averages from either the North or South.

2. <u>Comments Following Technical Conference</u>

38. CIG, Williams, Indicated Shippers, and Anadarko Petroleum Corporation (Anadarko) filed initial comments and reply comments.

a. <u>Initial Comments</u>

39. In its initial comments, CIG states that its proposed tariff revision is intended to reduce the opportunity for shippers to engage in geographic arbitrage, to align the cash-out prices to the actual purchase price of replacement gas, and to respond to operational challenges on CIG's system. With respect to arbitrage, CIG asserts that in order to change its cash-out System Index Price, it need only show that shippers have the opportunity for arbitrage, not that such arbitrage is actually taking place on its system.[23]

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

[23] CIG, Initial Comments at 7 (citing *Colorado Interstate Gas Co.*, 114 FERC ¶ 61,333, at P 12 (2006)).

CIG states that such an opportunity exists due to a disparity in prices and market conditions between its North and South systems. Specifically, CIG states that most receipts and deliveries on its system occur in its North system because natural gas prices have been significantly lower in the North system than in the South. CIG states that as a result, its North system is typically full and there are constraints in moving gas from the north to the south. CIG asserts that this price disparity gives shippers the opportunity to create pack or draft imbalances to game the existing cash-out System Index Price and force CIG to either purchase or sell gas to the shipper at a price that allows the shipper to realize a greater profit than it would otherwise realize in the marketplace. CIG states that both historical pricing data and projections of future supply growth in the Rocky Mountain region provide evidence that the price disparity will persist even after the Rockies Express (REX) pipeline goes into service.[24]

40. CIG next asserts that its proposal will provide significant operational benefits because the level of demand for North-to-South capacity on its system often exceeds the available supply, resulting in system constraints that restrict shipper flexibility. CIG argues that its proposed System Index Price would deter shippers from creating imbalances and would give CIG an added incentive to purchase makeup gas in the South, which would create displacement capacity that would help alleviate North-to-South constraints.

41. In their initial comments, Indicated Shippers argue that the rate moratorium established in CIG's most recent rate case prohibits CIG from implementing the cash-out price mechanisms it proposes herein. Indicated Shippers argue that CIG has not shown that its proposed change to the System Index Price is just and reasonable because CIG has not provided any data demonstrating that it is under-recovering costs under its current System Index Price, nor has CIG explained what percentage of make-up gas it purchases on the North and South systems. Furthermore, Indicated Shippers assert that CIG has not demonstrated that under the current System Index Price, gaming is actually occurring or that there is an imminent risk that it will occur.[25] Indicated Shippers also argue that CIG has sufficient tools under its existing tariff to deter gaming,[26] and that CIG's proposal would allow it to significantly over-recover its replacement gas costs.

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[24] The REX pipeline is a proposed 1,679-mile natural gas pipeline system which will run from Colorado to Ohio.

[25] Indicated shippers note that the Commission recently approved CIG's current System Index Price in order to address the gaming issue, and that CIG fails to discuss its experience under the current cash-out regime. Indicated Shippers, Initial Comments at 8 (citing *Colorado Interstate Gas Co.*, 114 FERC ¶ 61,333 (2006)).

[26] Indicated Shippers, Initial Comments at 10 (citing Colorado Interstate Gas Co., FERC Gas Tariff, First Revised Vol. No. 1, Substitute Fourth Revised Sheet No. 312).

42. In its initial comments, Williams states that CIG's data supporting its proposal are incomplete and flawed. Based on its own analysis of CIG's operational gas sale and purchase data, Williams asserts that CIG's over-collection would increase from $2.8 million under the current System Index Price to $23.5 million under the proposed System Index Price. Williams argues that such increased over-recoveries are excessive and cannot be effectively refunded to shippers through the LUF reimbursement percentage, which cannot go below zero. Furthermore, Williams states that CIG's proposed change to the System Index Price is based on a faulty premise that CIG makes its operational purchases at the highest price location 100 percent of the time. Williams argues that unless CIG's operational purchases were made entirely at the highest-priced point and during the most expensive week of the month, the proposed pricing mechanism will always create a systemic over-collection. Williams also challenges CIG's need to reform its System Index Price, noting that CIG's operational purchases cost less on average than its imbalance cash-out sales for seven of the twelve months ending June 30, 2006, and that the average operational purchase costs for the year were only $.28/Dth higher than imbalance cash-out sales costs.

43. In its initial comments, Anadarko states that CIG's proposed pricing provisions are unprecedented and that they will lead to inequitable results that act more like a penalty, which should be credited back to CIG's shippers. Anadarko states that unlike typical high/low cash-out mechanisms, which rely on the same index/indices to derive the high and low prices, CIG's proposal, which relies on two index prices, would allow CIG to cherry-pick the better market price, thereby increasing the probability that CIG will over-collect its costs.

b. Reply Comments

44. In its reply comments, CIG states that the protesting parties have failed to rebut CIG's showing that the "potential" for arbitrage exists under its current pricing mechanisms. CIG states that the protestors have misconstrued Commission precedent and that it need only show that the potential for price arbitrage exists. CIG also objects to the Indicated Shippers' argument that CIG has sufficient tools in place to prevent gaming on its system, because it is unable to determine whether a shipper is creating an imbalance until after the fact.

45. CIG next states that its proposal will not lead to cost over-recoveries because its proposal in Docket No. RP07-666-000 will make CIG and its shippers completely revenue neutral regarding any factor that affects system gas balance. In addition, CIG states that Williams' analysis is fundamentally defective because Williams fails to account for shippers' response to the price signal resulting from the revision to the System Index Price. Finally, CIG argues that the terms of its 2006 rate moratorium do not bar CIG from revising its cash-out mechanism. Rather, CIG argues, the language of the settlement only barred changes to base tariff rates.

46. In their reply comments, Indicated Shippers argue that CIG's failure to provide any evidence of gaming is essentially an admission that no gaming is occurring under the present mechanism. Indicated Shippers further note that the Commission recently recognized that CIG's prior mechanism created an inherent risk of gaming and approved CIG's current cash-out mechanism in order to mitigate that risk.[27] Further, Indicated Shippers object to CIG's assertion that Commission precedent requires only that CIG show the opportunity for arbitrage exists. They argue that the cases relied on by CIG are distinguishable from the situation here and that Commission precedent places a burden on the pipeline to show some evidence of under-recovery or gaming.[28]

47. In addition to reiterating the points made in its comments, Williams adds that the proposal will not give CIG an incentive to buy more gas in the South, rather, CIG will continue to search out the lowest-cost gas in order to generate profit.

48. In its reply comments, Anadarko states that CIG's proposals (i.e, its more draconian cash-out System Index Price and cash-out Index Price) are penalties and as such, they should not be assessed where reliability is not an issue and where such penalties will allow the pipeline to over-recover its costs. Finally, Anadarko argues that CIG has the burden to show the operational justification for implementing the new penalty, and that CIG's harsher cash-out proposals are analogous to proposals rejected by the Commission in *Texas Gas Transmission Corp*.[29]

3. <u>Discussion</u>

49. CIG seeks to justify its proposed modification of its System Index Price by claiming that under its current tariff and existing market conditions, shippers have an opportunity to engage in arbitrage. Furthermore, CIG asserts that its proposed System Index Price will provide operational benefits and better reflect market realities. However, for the reasons discussed below, we find that CIG has failed to provide adequate support to show that it is just and reasonable. Accordingly, we reject CIG's proposed System Index Price.

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[27] Indicated Shippers, Reply Comments at 5 (citing *Colorado Interstate Gas Co.*, 114 FERC ¶ 61,333, at P 3 (2006)).

[28] *Id.* (citing *Northern Natural Gas Co.*, 105 FERC ¶ 61, 172 (2003), *reh'g denied*, 107 FERC ¶ 61, 252 (2004), *aff'd sub. nom.*, *The Industrials v. FERC*, 426 F.3d 405 (D.C. Cir. 2005); *Transcontinental Gas Pipeline Corp.*, 91 FERC ¶ 61,004, *reh'g denied and clarified*, 91 FERC ¶ 61, 282 (2000)) .

[29] *Texas Gas Transmission Corp.*, 97 FERC ¶ 61,349 (2001) (*Texas Gas*).

50. In Order No. 637, the Commission allowed pipelines to amend their cash-out prices to deter gaming, stating that "pipelines may be able to change the methods by which they cash-out imbalances to eliminate the incentives for shippers to borrow gas from the pipeline because the cash-out price is less than the market price for gas."[30] However, in doing so, the Commission did not give pipelines *carte blanche* to amend these cash-out prices. Rather, the Commission limited these amendments, stating that "[a] pipeline may include in its tariff transportation penalties only to the extent necessary to prevent the impairment of reliable service."[31] Thus, in Order No. 637, the Commission recognized that arbitrage could occur and that pipelines did not always have sufficient tools to prevent such activity. While the Commission gave pipelines the ability to establish mechanisms to deter arbitrage, through reasonable penalties and changes to cash-out mechanisms, it reinforced the notion that these mechanisms were not without their limits.

51. CIG is correct in noting that subsequent to Order No. 637, the Commission has recognized that "a pipeline need not prove that arbitrage is actually occurring in order to modify its cash-out mechanisms, a pipeline need only demonstrate the opportunity for arbitrage."[32] CIG has already been authorized to implement cash-out provisions that are designed to prevent imbalance arbitrage opportunities. However, CIG is incorrect in presuming that it can increase the penalty aspects of its cash-out mechanism on the mere assertion that shippers have an opportunity to engage in arbitrage. Quite the contrary, the Commission requires that pipelines not only show that an opportunity for arbitrage exists, but also that their proposed cash-out mechanism does not go beyond what is necessary to minimize arbitrage,[33] i.e., evidence that existing provisions are insufficient to deter undesirable conduct. This sentiment was echoed by the United States Court of Appeals for the D.C. Circuit. When interpreting Order No. 637 and Order No. 637-A as they apply to a cash-out mechanism, the Court noted that pipelines may properly seek to deter

[30] *Regulation of Short-Term Natural Gas Transportation Services and Regulation of Interstate Natural Gas Transportation Services*, Order No. 637, FERC Stats. & Regs. ¶ 31,091, at P 31,314-15 *clarified*, Order No. 637-A, FERC Stats. & Regs. ¶ 31,099, *reh'g denied*, Order No. 637-B, 92 FERC ¶ 61,062 (2000).

[31] *Id.* at 31,314, *codified in* 18 C.F.R. § 284.12(b)(2)(v) (2007).

[32] *Colorado Interstate Gas Co.*, 114 FERC ¶ 61,333, at P 14 (2006) (*CIG*) (citing *Texas Gas Transmission Corp.*, 97 FERC ¶ 61,349, at 62,634 (2001)).

[33] *See Texas Gas*, 97 FERC ¶ 61,349 at 62,632-33 (accepting a cash-out mechanism based on weekly high/low index price changes and rejecting a cash-out mechanism based on daily high/low index price changes because the latter functioned as a penalty beyond what is necessary to deter arbitrage).

arbitrage, however, "lest cash-out rules unduly limit shipper flexibility, pipelines' efforts against arbitrage should not go too far."[34]

52. In the case at hand, although CIG's proposed System Index Price would likely deter arbitrage, it appears at this time to go beyond what is necessary to do so. CIG sets forth a reasonable case as to why the opportunity for arbitrage may currently exist on its system; however, CIG has provided no evidence that its current high/low index cash-out mechanism has been inadequate in deterring arbitrage that has resulted in harm to its system or its customers. As indicated in *CIG*, such a justification is necessary where a pipeline seeks to increase the harshness of its penalty system.[35] In *CIG*, the Commission recognized that the addition of a fifth week to the end of a four-week cash-out period under CIG's prior tariff mechanism would make it more difficult for shippers to predict the ultimate average price and therefore would deter arbitrage.[36] The Commission also noted that this type of revision has been approved by a federal court and would not make CIG's penalty system any more harsh that it already was.[37] The Commission also accepted in *CIG* the switch from a cash-out mechanism that used the average of two pricing points to a high/low pricing mechanism among the two points (i.e., CIG's current cash-out System Index Price), while noting that such modification does not necessarily make the penalty harsher.[38]

53. While the Commission has generally accepted the use of high/low cash-out pricing mechanisms,[39] it has also consistently rejected pipelines' proposals that have gone too far by seeking extensions of those high/low mechanisms. The United States Court of Appeals for the D.C. Circuit summarized such instances as follows:

> [T]he Commission has rejected mechanisms that provided cash-outs for imbalances measured over periods much shorter than a month. *ANR Pipeline Co.*, 103 FERC ¶ 61,252 (2003), *order on reh'g*, 105 FERC ¶ 61,236 (2003) (five days); *Williams Gas Pipelines Central, Inc.*, 100 FERC ¶ 61,232

[34] *The Industrials v. Federal Energy Regulatory Commission*, 426 F.3d 405, 407 (2005).

[35] *CIG*, 114 FERC ¶ 61,333 at P 14-15.

[36] *Id.* at 14.

[37] *Id.* (citing *The Industrials*, 426 F.3d at 407-08).

[38] *Id.* at 15-16.

[39] *Id.* at 16; *The Industrials*, 426 F.3d at 407-08 (citing *Gulf South Pipeline Co.*, 97 FERC ¶ 61,069 (2001), *order on reh'g*, 98 FERC ¶ 61,068 (2002)).

> (2002), *order on reh'g*, 102 FERC ¶ 61,119 (2003) (daily). The shorter the period of calculation, the more stringent the sanction is likely to be, as the shipper gets less benefit from the netting out of short-term positive and negative imbalances. As a result, the proposals went too far in reducing arbitrage incentives. And the Commission has similarly rejected systems that would have used as benchmarks the high/low of average prices from periods of less than one week, as in *Transcontinental Gas Pipe Line Corp.*, 91 FERC P 61,004 (2000).[40]

54. Together, *ANR*, *Williams* and *Transco* show the Commission's general reluctance to increase the severity, or harshness, of high/low cash-out pricing mechanisms where the effect would be to increase the "high" price for cash-out sales by the pipeline and decrease the "low" price for cash-out purchases. In the examples mentioned above, the pipelines' proposals had the effect of polarizing the high and the low prices by either shortening the period of calculation of the imbalance or shortening the period of time for calculating the average high/low prices. Though different in form, CIG's proposal here has a polarizing effect similar to *ANR*, *Williams* and *Transco*. Specifically, CIG's proposal would charge shippers the highest weekly average price from the South system, instead of the highest weekly average among the North and South systems, regardless of where it purchased replacement gas for that period. Similarly, under CIG's proposal, CIG would pay shippers the lowest weekly average price from the North system, instead of the lowest weekly average among the North and South systems. Therefore, we determine that CIG's proposed modification to its System Index Price goes beyond what is necessary to prevent arbitrage, acts more as a penalty in contravention of Order No. 637, and therefore is unjust and unreasonable.

55. CIG must provide sufficient justification to support the more draconian penalties it proposes here, and it has not done so on this record. CIG must at a minimum make some showing that it is currently experiencing operational difficulties or that its shippers are currently arbitraging its system. Nowhere in its filings does CIG discuss its experience under the current System Index Price, which was approved by the Commission to address the very opportunity for arbitrage CIG complains of here.[41] Moreover, CIG provides no data comparing its current purchases and sales of operational gas against its cash-out recoveries under the System Index Price. Thus, on the record before us, we are unable to find that CIG's proposed System Index Price is just and reasonable. Accordingly, we reject CIG's proposed System Index Price modification.

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

[41] *CIG*, 114 FERC ¶ 61,333 at P 16.

B. Cash-out Index Price

1. Background

56. CIG also proposes to change the manner in which it calculates the cash-out Index Price, which CIG uses to convert liquid revenues to gas equivalents in computing its quarterly LUF reimbursement percentage. In place of its current tariff provision defining the Index Price as the average of daily midpoint index prices for the North and South index points, CIG proposes to always use the higher of the daily North or South prices in calculating cash-out prices, thereby increasing the LUF recovered from shippers to a level CIG asserts is more economically neutral.

2. Comments Following Technical Conference

a. Initial Comments

57. CIG states that, due to the constraints discussed above, it is generally unable to replace shrinkage volumes on the North system. Therefore, CIG argues that it is inappropriate to use an average of North and South prices in its Index Price, as this implicitly assumes that half of CIG's purchases occur on the North system.

58. Indicated Shippers object to the cash-out Index Price as unfairly minimizing the Dth-equivalent of liquids, which they argue would lead to an upward impact on fuel rates.

59. Williams also objects to the cash-out Index Price proposed by CIG, arguing that CIG's proposal will reduce the processing revenue credit, representing a significant windfall to CIG. Williams states that this will deprive shippers of the full processing revenue credits they bargained for and obtained in settlement of the liquids revenue crediting issue. Furthermore, Williams states that if the Commission does not reject CIG's proposed Index Price, it should require CIG to calculate the processing revenue credit using the average costs of CIG's actual operational purchases.

b. Reply Comments

60. CIG acknowledges that the Dth-equivalent credit or liquid revenues will be less under its proposal than under the current system, however, it argues that its proposed "higher-of" Index Price will better reflect the operational realities on CIG's system and thereby incentivize CIG to purchase operational gas where it will help the efficient and flexible functioning of its system. Furthermore, CIG notes that under its proposal in Docket No. RP07-666-000, any additional LUF collections will flow back to shippers, thereby making shippers whole.

61. Indicated Shippers argue that CIG's proposed Index Price ignores the fact that it will need to buy shrinkage gas on both the North and South systems to support operations. Indicated Shippers further argue that while CIG may not buy equal gas

quantities on the North and South system, its proposal goes beyond what is necessary to recover its costs.

3. Discussion

62. As with its proposed System Index Price, CIG fails to sufficiently support its proposed cash-out Index Price. Without a more comprehensive showing of where CIG purchases make-up gas to replace shrinkage volumes, we are unable to find that CIG's proposed methodology is just and reasonable. Therefore, we reject CIG's proposed modifications to its cash-out Index Price.

63. CIG's proposal would effectively increase the Index Price by taking the "higher of" the daily North or South prices as opposed to an average of the North and South. This would, in turn, have the effect of reducing the volume of gas credited to shippers in CIG's LUF tracking mechanism (both its current volumetric tracking mechanism and its new economic tracking mechanism). CIG supports its proposal by stating that due to constraints on the North system and because CIG has the lowest scheduling priority in its purchases of make-up gas, it is often forced to make purchases on the more expensive South system. Therefore, CIG argues that it is often paying more money on replacement gas that it is recouping from shippers through its tracking mechanism.

64. CIG, however, makes no affirmative showing of how often and where it purchases gas to make up for shrinkage volumes. Instead, CIG argues that amending its Index Price to a "higher of" methodology will provide operational benefits by incentivizing CIG to purchase more expensive gas on the South system to resolve North to South constraints. Yet in all likelihood the opposite result will ensue. The actual economic incentive will be for CIG to purchase the lowest-cost gas possible in order to lower the shrinkage credit to shippers. Accordingly, in the absence of more specific information showing that CIG is under-recovering its costs, we determine that CIG's proposed Index Price methodology has not been shown to be just and reasonable, and may act as an impermissible penalty to shippers.

65. As discussed above, Order 637 required pipelines to narrowly design penalties to deter conduct that is harmful to a pipeline's system.[42] CIG's proposed Index Price, however, is not intended to deter any type of conduct at all. Rather, the "higher of" methodology penalizes shippers by reducing the Dth-equivalent of liquid revenues. Because this penalty has no deterrent effect, it is not justified under Order 637. CIG argues that it will more accurately track costs and incentivize CIG to purchase gas in the South. However, CIG provides little support for its assertion that the Index Price will more accurately track costs, or will impel CIG to purchase more expensive make-up gas. Therefore, we reject CIG's proposed cash-out Index Price for the reasons stated above.

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

The Commission orders:

(A) CIG's proposed tariff sheets filed in Docket No. RP07-666-000 and referred to in footnote 1 of this order, are accepted effective March 1, 2008, subject to conditions as discussed herein.

(B) CIG's proposed tariff sheet filed in Docket No. RP07-667-000 and referred to in footnote 2 of this order, is rejected, for the reasons discussed herein.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.