UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Tennessee Gas Pipeline Company

Docket Nos. RP00-477-004, RP00-477-005, RP01-18-004, RP98-99-009, and RP03-183-001

ORDER ON REHEARING AND COMPLIANCE FILING

(Issued August 9, 2004)

1. Tennessee Gas Pipeline Company (Tennessee) and others requested clarification and/or rehearing of the Commission's July 11, 2003 order (July 11 Order)[1] on Tennessee's compliance with Order No. 637, *et seq*.[2] On August 11, 2003, Tennessee also filed tariff sheets[3] in compliance with the July 11 Order. The Commission grants in part and denies in part the requests for clarification and/or rehearing, and accepts Tennessee's proposed tariff sheets as indicated in the Appendix to this order.

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[1] Tennessee Gas Pipeline Company, 104 FERC ¶ 61,063 (2003) (July 11 Order).

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

[3] *See* the Appendix to this order for the list of proposed tariff sheets and effective dates.

Background

2. On June 3, 2002, Tennessee filed, in Docket No. RP00-477-003, *et al*., tariff sheets in compliance with Order No. 637, *et seq*. and an order on compliance issued April 3, 2002 (April 3 Order).[4] Tennessee and others filed requests for rehearing of the April 3 Order. In addition, Tennessee filed in compliance with the Commission's O*rder on Remand*.[5] In the July 11 Order, the Commission partially granted and denied rehearing, and found that Tennessee generally complied with the requirements of Order No. 637 and the April 3 Order, subject to certain modifications. Pertinent parts of the April 3 Order and the July 11 Order are discussed below.

3. Tennessee, the East Ohio Gas Company d/b/a Dominion East Ohio and The Peoples Natural Gas Company d/b/a Dominion Peoples (Dominion), the Indicated Shippers,[6] National Fuel Gas Distribution Corporation (National Fuel), and Clarksville[7] request rehearing and/or clarification of the July 11 Order.

Rehearing Requests

OFO and Hourly Flow Limitations

4. In its Order No. 637 compliance filing, Tennessee proposed to revise its Operational Flow Order provisions to include a provision that would require any customer "to adjust their hourly quantities such that the customer will deliver and receive gas in uniform hourly quantities during the day." Since Tennessee's existing OFO provisions did not contain such an hourly flow requirement, the April 3 Order required Tennessee to either remove the proposed uniform hourly flow requirement from its OFO

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[4] Tennessee Gas Pipeline Company, 99 FERC ¶ 61,017 (2002) (April 3 Order).

[5] 101 FERC ¶ 61,127 (2002).

[6] Amerada Hess Corp.; Anadarko Petroleum Corp.; ChevronTexaco Natural Gas, a division of Chevron U.S.A. Inc.; Conoco Inc.; ExxonMobil Gas Marketing Co. (a Division of Exxon Mobil Corp.); Occidental Energy Marketing, Inc.; and Shell Offshore Inc. (Indicated Shippers).

[7] The Cities of Clarksville, Springfield, Portland, and Waynesboro, Tennessee, the Corinth Public Utilities Commission, Mississippi, the West Tennessee Public Utility District, the Greater Dickson Gas Authority, and the Humphreys County Utility District (Clarksville).

provisions or limit it to those services that are subject to the requirement under the terms of their rate schedules. In the July 11 Order, the Commission clarified that it did not intend to afford Tennessee any greater rights to require uniform hourly quantities than what is reflected in the rate schedule under which service is provided. These rate schedules provide: "As nearly as practicable, Shipper shall deliver and receive gas in uniform hourly quantities during any day."[8] Therefore, in the July 11 Order, the Commission required Tennessee to make its OFO language similar to that of its rate schedules by adding the phrase "as nearly as practicable" when it referred to the rate schedules.

5. Tennessee seeks clarification or, in the alternative, rehearing of the requirement to add the "as nearly as practicable language." Tennessee argues that it added the hourly flow provision to its OFO provisions to comply with Order No. 637's requirement for a pipeline to provide as much information as possible in its tariff as to the circumstances under which the pipeline will invoke an OFO. Tennessee argues that the protestors clearly intended the impact of the "as nearly practicable" language as a complete waiver of the requirement to comply with an OFO even though they could physically restrict their takes to uniform hourly flows. Tennessee states that its system and level of contracted service is based on being able to enforce uniform hourly levels of service under Rate Schedule FT-A, and that ignoring an OFO to limit hourly flows could cause a system failure. Tennessee argues that leaving compliance with an OFO ill-defined and subject to interpretation vitiates Tennessee's ability to safely and reliably operate its pipeline. Tennessee contends the Commission should follow *Columbia*.[9] in which the Commission permitted Columbia to implement hourly restrictions beyond those provided for in its tariff and/or service agreements.

6. Upon further review of Tennessee's tariff, the Commission will grant rehearing and permit Tennessee to implement an hourly flow restriction in its OFO provisions applicable to all rate schedules, as it initially proposed. Tennessee's existing provisions for action alerts state:

> Requested Actions: Upon issuance of an Action Alert, Transporter can request that an OFO Recipient take any of the following actions, *or other similar actions*, to the extent that such actions would alleviate the situation:

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[8] *See* Rate Schedule FT-A, § 4.11, Fifth Revised Volume No. 1, Substitute Third Revised Sheet No. 159A.

[9] Columbia Gas Transmission Corp., 100 FERC ¶ 61,084 at P 250 (2002), *rehearing denied*, 104 FERC ¶ 61,168 at P 29 (2003).

> (i) increase or decrease injections into the system at specified receipt areas;
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> (ii) begin withdrawals from system storage or decrease injections into system storage; and/or;
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> (iii) bring the nominations at specified delivery areas within designated balancing tolerances, provided, however, that Transporter shall not require DDS service to take such actions unless Transporter also requires similar actions to be taken by its firm storage services.

7. The inclusion of hourly flow limitations to Tennessee's OFO provisions is sufficiently similar to bringing nominations within designated balancing tolerances that such actions were already encompassed by Tennessee's existing tariff.[10] Thus, the Commission agrees with Tennessee that its proposal complies with Order No. 637 by making its existing tariff clearer.[11]

8. Limiting shippers' ability to exceed hourly flow limits is consistent with the purpose of allowing OFOs: to permit pipelines to take actions necessary to prevent serious operational difficulties on their systems. The Commission has permitted other pipelines to implement such hourly flow limitations in OFO provisions,[12] and limiting shippers to uniform hourly flows is less burdensome on shippers than other OFO

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[10] In filings to comply with Order No. 636, the Commission permitted pipelines to include catch-all provisions for OFOs, concluding that the pipeline "cannot reasonably forecast and place in its tariff all situations which would require issuance of an OFO." Texas Gas Transmission Corp., 64 FERC ¶ 61,083 at 61,819 (1993). Thus, the fact that Tennessee's existing tariff did not specifically list hourly flow limitations does not mean that such limitations do not fall within the catch-all provision "other similar actions."

[11] *See* § 284.12(b)(2)(iv) (requiring pipelines to set forth clear standards in tariffs for OFOs).

[12] Texas Gas Transmission Corp., 64 FERC ¶ 61,083 at 61,819 (1993); United Gas Pipe Line Company, 65 FERC ¶ 61,006 at 61,075 (1993); Texas Eastern Transmission Corp., 63 FERC ¶ 61,100 at 61,474 (1993); Dominion Transmission, Inc., 95 FERC ¶ 61,316 at 62,089 (2001); and KO Transmission Company, 98 FERC ¶ 61,093 at 61,286 (2002).

provisions the Commission has permitted.[13] As Tennessee points out, the Commission has already found in an earlier order that the "ability of the customer to take in excess of 1/24 of its MDQ is not a firm entitlement, and that no Rate Schedule FT-A customer has a firm right to hourly flexibility."[14] Thus, consistent with the Commission's determination in *Columbia*, Tennessee should be permitted to add an hourly flow limitation provisions to its OFO provisions to be applied only when such actions are needed to protect system integrity. Tennessee may refile its tariff to include such a provision.

Segmentation

Compliance with Texas Eastern/El Paso Policy

9. In Order No. 637, the Commission required pipelines to justify deviations from the Texas Eastern/El Paso policy, under which the releasing and replacement shippers in segmented releases are both able to choose primary points consistent with their mainline contract demand. In the April 3 Order, the Commission found that Tennessee's existing tariff permitted all shippers to change from secondary points to primary points and was, therefore, in compliance with the Texas Eastern/El Paso policy. In its request for rehearing of the April 3 Order, Tennessee claimed the Commission had misread its tariff and that its tariff did not permit elevation of secondary points to primary points. In the July 11 Order, the Commission no longer relied upon an interpretation of Tennessee's existing tariff, but found, under section 5, that Tennessee's system does not warrant a variance from the Texas Eastern/El Paso policy, and required Tennessee to comply with that policy. The Commission also rejected Tennessee's alternative proposal to charge an extra fee for changing from secondary to primary points as being inconsistent with the Texas Eastern/El Paso policy.

10. In its rehearing request, Tennessee reiterates its argument that the Commission has misread Tennessee's tariff and requests that the Commission clarify that allowing a shipper to elevate a secondary point to a primary point is not a matter of tariff interpretation.

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[13] For example, the Commission has permitted pipelines to require firm shippers to flow gas from primary receipt points even when the shipper has not nominated any gas on that day. *See* Northwest Pipeline Corporation, 71 FERC ¶ 61,315 at 62,225 (1995). Such a requirement is more burdensome on shippers than merely limiting their already-nominated quantities to a uniform hourly flow.

[14] Tennessee Gas Pipeline Co., 76 FERC ¶ 61,022 at 61,138 (1996).

11. Tennessee further contends that the Commission erred in rejecting its proposal to impose additional reservation charges when replacement or releasing shippers change from secondary to primary points. Tennessee contends that the fact that it does not have an existing tariff provision permitting such charges (as stated in the July 11 Order) is not relevant because under its existing tariff, such elevation of points is not permitted. Tennessee also argues that the Commission erred in finding that such a charge is inconsistent with Texas Eastern/El Paso policy and that the Commission failed to satisfy its Section 5 burden in rejecting such a charge. Tennessee contends that the Commission's sole justification for rejecting its elevation charges is that the replacement shipper has signed its own independent contract and therefore has the right to select primary points and Tennessee is still collecting the same revenue from the releasing shipper. Thus, Tennessee continues, the Commission's position is that for reservation charges, the replacement contract is a dependent contract whose reservation charges are covered by the charges applied to the releasing contract, but for primary points the replacement contract is an independent contract not limited by the releasing contract. This switching of criteria, Tennessee alleges, is arbitrary and capricious.

12. The Commission denies the rehearing request. The Commission requirement that Tennessee comply with the Texas Eastern/El Paso policy is not based on an interpretation of Tennessee's current tariff, but rather the Commission's determination, under section 5 of the NGA, that there is no basis for Tennessee to deviate from the Texas Eastern/El Paso policy.

13. In Order No. 637, the Commission found that pipelines had not always permitted segmentation in their Order No. 636 tariffs, and, therefore, promulgated a regulation requiring pipelines to permit segmentation.[15] As part of segmentation, the Commission, in Order No. 637, required pipelines to comply with its long-standing Texas Eastern/El Paso policy, or to provide justification for deviating from this policy.[16] The Commission explained, under the Texas Eastern/El Paso policy:

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[15] 18 C.F.R. § 284.7(d) and Regulation of Short-Term Natural Gas Transportation Services, Order No. 637, 65 FR 10156, FERC Stats. & Regs. Regulations Preambles ¶ 31,091 at 31,301 (2000).

[16] Order No. 637 at 31,302.

> The releasing and replacement shippers must be treated as separate shippers with separate contract demands. Thus, the releasing shipper may reserve primary points on the unreleased segment up to its capacity entitlement on that segment, while the replacement shipper simultaneously reserves primary points on the released segment up to its capacity on that segment.[17]

14. In Order No. 637-A, the Commission further explained that allowing replacement and releasing shippers to choose their own primary points in a segmented release was important to the creation of effective competition between released capacity and the pipelines' sale of capacity:

> Permitting flexibility in the selection of primary points in segmented releases can be important to creating effective competition between pipeline services and released capacity. If replacement shippers were limited to the use of segmented points on a secondary basis, as some of the rehearing requests suggest, the pipeline would still retain the right to sell that receipt point on a primary basis. The ability to sell points on a primary basis would provide the pipeline with a competitive advantage over segmented release transactions. In order to equalize competition between pipeline and released capacity, pipelines need to permit shippers greater flexibility in selecting primary points than they have in the past.[18]

15. On appeal, the Court of Appeals for the District of Columbia Circuit affirmed the Commission's requirement to apply the Texas Eastern/El Paso policy, accepting the Commission's explanation for the policy:

> In the Commission's view, segmentation must be coupled with flexible point rights in order to create effective competition between pipeline services and released capacity. Order No. 637-A at 31,594. Take the Commission's own example of a shipper holding firm capacity between the Gulf of Mexico and New York. That shipper could release the portion or segment of its firm capacity between the Gulf and Atlanta to a replacement shipper, permitting the replacement shipper to use the segment to deliver gas to Atlanta;

[17] Order No. 637 at 31,302.

[18] Order No. 637-A, 65 FR 35705 (June 5, 2000), FERC Stats. & Regs. Regulations Preambles ¶ 31,099 at 31,594 (May 19, 2000).

> meanwhile the releasing shipper would retain its firm capacity between Atlanta and New York, allowing it to ship gas from Atlanta to New York. Order No. 637 at 31,301. In this situation, both the releasing and the replacement shippers need to have the ability to change their primary receipt and delivery points from the ones designated in their contracts so as to be able to effectively make use of the segmented capacity; for instance, the replacement shipper needs to designate Atlanta as its primary delivery point, now that it has acquired rights to capacity in the mainline segment terminating there. If the replacement shipper were limited to less-than-primary rights at Atlanta, then the releasing shipper could not compete effectively with the pipeline as a seller of capacity, because the pipeline would have the right to sell capacity to the Atlanta point on a primary basis.[19]

The court rejected the argument that such a policy abrogated pre-existing contract rights, finding that this policy continued the policy on flexible point rights adopted in Order No. 636, which started the restructuring process.

16. Tennessee's objections to the Texas Eastern/El Paso policy represent collateral attacks on the Commission's original finding in Order No. 637 that pipelines must, at a minimum adhere to this policy, unless they could demonstrate that it was inapplicable to their systems. In the July 11 Order, the Commission found that any deviation from this policy was not justified on the Tennessee system: "Tennessee is seeking an exemption from the Texas Eastern/El Paso policy for its entire system; it has not tried to limit its exemption only to the reticulated portions of its system. As a general matter, Tennessee is a straight line pipeline and cannot justify a blanket exemption from the Texas Eastern/El Paso policy because it may have some reticulated portions."[20] Tennessee has not challenged this finding in its rehearing petition.

17. Tennessee instead argues that the Commission has adopted inconsistent rationales for the Texas Eastern/El Paso policy: it argues that the Commission finds, on the one hand, that the replacement contract is a dependent contract whose reservation charges are covered by the charges applied to the releasing contract, but, on the other hand, that the replacement contract is an independent contract not limited by the releasing contract for

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[19] Interstate Natural Gas Association of America, Petitioner v. FERC, 285 F.3d 18, 39-41 (D.C. Cir. 2002) (*INGAA*).

[20] July 11 Order at P 20.

the purpose of choosing primary points. In the first place, this argument is a collateral attack on the Commission's findings in Order Nos. 636 and 637, in which the segmentation policy was adopted.

18. Moreover, the Commission does not find an inconsistency in its position. A capacity release contract clearly derives from the releasing shipper's underlying firm contract. Under a release, Tennessee is guaranteed to be paid the releasing shipper's reservation charge regardless of what rate the replacement shipper pays to reserve the capacity. Therefore, the replacement shipper's rights to use the system are derived from the releasing shipper's rights.[21] In Order No. 636, the Commission recognized that the replacement shipper's contract derives from the underlying agreement, stating that "the pipeline itself should be indifferent to the substitution [of the replacement shipper for the releasing shipper] because its total contract demand will remain unchanged."[22]

19. At the same time, the capacity release mechanism established in Order No. 636 provided that the replacement shipper would have an independent contract with the pipeline. Under the capacity release regulations, the pipeline sells the capacity to the replacement shipper and enters into a standard service agreement with the replacement shipper.[23] The replacement shipper, for example, is responsible for satisfying all of the

[21] For example, if the releasing shipper pays the maximum rate, the replacement shipper is entitled to full receipt and delivery point flexibility even if it pays a discounted rate. This is because the capacity used by the replacement shipper is already fully paid for by the releasing shipper.

[22] Order No. 636, FERC Stats. & Regs. Regulations Preambles ¶ 30,939 at 30,419 (1992).

[23] The releasing shipper is credited with the proceeds of the release, but does not have privity of contract with the replacement shipper. *See* Order No. 636-A, FERC Stats. & Regs. Regulations Preambles ¶ 30,950 at 30,565 (Commission will not establish contractual privity between releasing and replacement shippers).

pipeline's tariff provisions governing shipper eligibility. Once the replacement shipper enters into a contract with the pipeline, "the replacement shipper becomes a shipper like any other shipper."[24]

20. The Commission, in its orders in individual Order No. 636 restructuring proceedings, and in Order No. 637, with respect to segmented releases, found that in such segmented releases, the replacement and releasing shippers must, consistent with Order No. 636, be treated as separate shippers with the ability to choose primary points equal to their contract demand.[25] If the two shippers were unable to choose primary points, then the pipeline could displace the release transaction by selling the point to another shipper. When the pipeline operated as a merchant, it could segment capacity in order to serve two customers. In order to ensure that releasing shippers can use the capacity for which they pay in the same way as the pipeline can, the releasing and replacement shipper's must be able to treat the release as two separate contracts, both with the right to use primary points. As the Court in *INGAA* recognized, as an "application of the [Commission's]

[24] Order No. 636, FERC Stats. & Regs. Regulations Preambles ¶ 30,939 at 30,419 (1992). In a recent case, *Tenaska Marketing Ventures v. Northern Border Pipeline Co*., 99 FERC ¶ 61,182 (2002), the Commission recognized capacity release contracts are both independent and derivative agreements. In *Tenaska*, the Commission found that a pipeline was not required to terminate a replacement shipper's contract upon the termination of the releasing shipper's contract because the replacement shipper's contract was an independent contract between the pipeline and the replacement shipper. At the same time, the Commission recognized that the contract with the replacement shipper is derivative, since the pipeline did not agree to the replacement shipper's rate, and is not required to accept a lower rate. The Commission recognized that in such cases, pipelines may want to include tariff provisions permitting them to terminate the replacement shipper's contract. 99 FERC ¶ 61,182 at 61,709. In subsequent cases, the Commission found that pipelines could terminate replacement shippers' contracts only if the replacement shipper is unwilling to meet the releasing shipper's rate. *See* Texas Eastern Transmission, L.P., 101 FERC ¶ 61,071 at P 6 (2002); Trailblazer Pipeline Co., 101 FERC ¶ 61,405 at P 32 (2002); Northern Border Pipeline Co., 100 FERC ¶ 61,125 (2002); Natural Gas Pipeline Co. of America, 100 FERC ¶ 61,269 at P 7-19 (2002); Canyon Creek Compression Co., 100 FERC ¶ 61,283 (2002); and Kinder Morgan Interstate Gas Transmission LLC, 100 FERC ¶ 61,366 (2002).

[25] *See* Order No. 637, FERC Stats. & Regs. Regulations Preambles ¶ 31,099 at 31,594 (May 19, 2000); Texas Eastern Transmission Corp., 63 FERC ¶ 61,100 at 61,452 (1993); and El Paso Natural Gas Co., 62 FERC ¶ 61,311 at 62,991 (1993).

operational feasibility principle … the releasing and replacement shippers must be treated as separate shippers with separate contract demands. (emphasis added)."[26]

21. Tennessee also maintains that the Commission has not justified its rejection of Tennessee's proposal to charge rates for the elevation of secondary to primary points. But, as pointed out above, such a policy would be inconsistent with the Texas Eastern/El Paso policy, because it would impose costs on release transactions that are not imposed on pipeline transactions. Moreover, Tennessee has not shown that such a charge is necessary for it to recover its cost-of-service.

22. Tennessee's rates were designed to permit it to recover its full cost of service based on revenues from its primary firm contract shippers and interruptible customers. Thus, the primary shippers' contract demand reservation charges (not the replacement shippers' contract demand and throughput) are used to recover fixed costs allocated to firm customers' reservation rates. This means that the primary contract shippers are already paying in full for all fixed costs allocated to the reservation charge. The releasing shippers' revenue responsibilities do not change simply because they release capacity to a replacement shipper. Tennessee is made whole for these costs.[27] Therefore, no additional charge is needed to permit Tennessee to recover its cost of service. Moreover, the imposition of such an added charge would constitute undue discrimination, since the total maximum rate paid by the replacement shipper for capacity would be greater than the maximum rate paid by similarly situated shippers contracting directly with Tennessee.[28]

23. Tennessee maintains that even with the charge to elevate primary points, the replacement shipper still is an advantageous position with respect to the purchase of capacity directly from Tennessee, because the rate structure is primarily based on usage rather than a demand charge. The Commission fails to understand this claimed distinction, since Tennessee itself states that its charge for elevating points would be a

[26] INGAA at 40.

[27] The Commission stated in Order No. 636 that the pipeline should be indifferent to the substitution of the replacement shipper because the releasing shipper remains liable for the reservation charges and its total contract demand will remain unchanged. Order No. 636 at 30,419.

[28] 18 C.F.R. § 284.7(b)(1) (a pipeline cannot discriminate on the basis of customer classification).

small reservation charge.[29] In any event, the Commission does not see how the sale of capacity by Tennessee would not have a competitive advantage over the release transaction. It would always cost the replacement shipper more to obtain a primary point for released capacity than it would if it obtained the capacity from the pipeline at the same rate. For instance, if the replacement shipper obtained a segmented release at the maximum rate for the capacity, it would have to pay the additional charge to claim a primary point. However, if the shipper purchased capacity from Tennessee, it would only have to pay the maximum rate for the capacity, giving Tennessee an advantage, however slight over the release transaction.

24. Tennessee asserts that the point elevation charge is necessary to prevent hording of primary point capacity. But as the Commission has explained in Natural Gas Pipeline Company of America and ANR Pipeline Company,[30] hoarding is not an issue under the Texas Eastern/El Paso policy, since each shipper obtains primary points only up to its contract demand.

25. Order No. 637's recognition of a possible need to deal with hoarding occurred in the context of a discussion of whether pipelines should permit shippers to have primary point rights that exceed their individual contract demand. As the Commission explained: "on a fully subscribed pipeline where receipt point capacity exceeds mainline capacity fivefold, the pipeline can seemingly permit shippers to select primary receipt point rights well in excess of their mainline contract demand, since the pipeline has no capacity left to sell and, therefore, needs to reserve no receipt point capacity in order to sell unsubscribed capacity."[31] In that situation (where a shipper can obtain primary points *exceeding* its contract demand), the Commission recognized that the pipelines may need to take action to limit hoarding of capacity.[32]

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[29] Tennessee Rehearing Request at 13.

[30] Natural Gas Pipeline Company of America, 103 FERC ¶ 61,174 at P 16-18 (2003) (*NGPL*) and ANR Pipeline Company, 104 FERC ¶ 61,320 at P 23-27 (2003).

[31] Order No. 637-A at 31,594.

[32] Order No. 637-B, 92 FERC ¶ 61,062 at 61,167 (2000).

26. But this situation is not at issue with respect to the application of the Texas Eastern/El Paso policy. Tennessee is only required to provide a shipper in a segmented transaction with primary point rights that equal its contract demand. Tennessee has not shown that allowing replacement shippers to obtain primary point capacity equal to their contract demand will result in hoarding of capacity.

27. In addition, the Commission's policies ensure that application of the Texas Eastern/El Paso policy does not unreasonably inhibit a pipeline's ability to market its capacity. These policies establish a reasonable balance between the need to enhance competition by providing replacement shippers with the right to obtain primary points and the pipeline's interest in selling available firm capacity. First, the Commission permits the pipeline to limit the primary point capacity a shipper can reserve to its mainline contract demand, so that if a shipper does change to another primary path, the pipeline could require the shipper to give up an existing primary point. Second, replacement shippers can obtain primary points only when those points are available and those points revert to the pipeline for sale at the expiration of the release. Third, if a replacement shipper obtains primary points by changing the releasing shipper's primary points, the change is permanent and the pipeline can sell the newly available capacity at the original primary points to new shippers. Finally, the Commission has allowed Tennessee to use the net present value (NPV) method to allocate point capacity and has treated the bid of an existing shipper (including a replacement shipper) to change to another primary point without increasing its reservation charge as having an NPV of zero, in contrast to the bid of a new shipper bringing new revenue to the pipeline.[33] This ensures that bids providing additional revenue to the pipeline will have priority over point changes by replacement or other existing shippers. All these factors adequately protect Tennessee's ability to market its capacity and there is no need to permit Tennessee to apply an additional charge for elevating points in segmented releases.

Limits on Segmentation

28. In the July 11 Order, the Commission rejected Tennessee's request to impose certain conditions on segmented releases.[34] Tennessee requests rehearing of the Commission's rejection of Tennessee's seven proposed limitations on segmentation. Tennessee claims that the Commission did not provide any justification for its finding.

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[33] Process Gas Consumers Group v. FERC, 292 F.3d 831 (D.C. Cir. 2002), *aff'g* Tennessee Gas Pipeline Co., 94 FERC ¶ 61,097 (2001), 91 FERC ¶ 61,053 (2000); and ANR Pipeline Co., 97 FERC ¶ 61,322 (2001).

[34] 104 FERC ¶ 61,063 at P 145-147 (2003).

Tennessee submits that its proposed restrictions are directed to a shipper taking primary point capacity outside of the original contract capacity path and gas flow in the opposite direction as the releasing shipper's contract. Tennessee asserts that the Commission's findings are inconsistent and go beyond the requirements of both Order No. 637 and the Texas Eastern/El Paso policy.[35]

29. In Order No. 637, the Commission did permit several limitations on segmented releases. For example, segmented releases must be within the zone(s) for which the releasing shipper pays and the combined nominations of the shipper and replacement shipper cannot exceed the contract demand of the releasing shipper on the same segment.[36] As a consequence of this rule, releasing and replacement shippers cannot choose primary points that overlap.[37] Applying these principles, we will examine Tennessee's seven proposed limitations.[38]

30. **Proposal 1**:

> Segmented Primary Point Capacity is only available if capacity is generally available at the selected point and the Releasing and/or Replacement Shipper is awarded the capacity through the open season procedures set forth in Article XXVIII, Section 5 of the

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[35] *Citing* OkTex Pipeline Co., 98 FERC ¶ 61,214 at 61,824 (2002) (OkTex); East Tennessee Natural Gas Co., 98 FERC ¶ 61,060 at 61,149 (2002) (East Tennessee); Kinder Morgan Interstate Gas Transmission LLC, 97 FERC ¶ 61,062 at 61,336-37 (2001) (Kinder Morgan); and National Fuel Gas Supply Corp., 96 FERC ¶ 61,182 at 61,808 (2001) (National Fuel).

[36] Order No. 637-A, FERC Stats. & Regs. Regulations Preambles ¶ 31,099 at 31,591-96.

[37] Kinder Morgan Interstate Gas Transmission, 103 FERC ¶ 61,216 at P 44 (2003) (Under Texas Eastern/El Paso policy, "the releasing shipper and the replacement shipper can each choose primary points up to its applicable contract quantity if the resulting paths do not overlap").

[38] These proposals are on Fifth Revised Sheet No. 339A and Original Sheet No. 339B filed in Tennessee's June 3, 2002 compliance filing.

> General Terms and Conditions. Point capacity reserved by the Transporter to sell generally available mainline capacity to or from the point shall not be available as Segmented Primary Point Capacity.

31. The Commission grants rehearing, in part, with respect to this proposal. The Commission made clear in Order No. 637 that primary points can only be chosen to the extent that capacity at those points is available.[39] As discussed in the last section, Tennessee may apply its current tariff provisions providing for the use of NPV calculations in evaluating bids for mainline capacity against requests by shippers to establish new primary points.

32. However, the Commission is not clear as to the meaning of the last sentence of this provision, stating that Tennessee can "reserve" capacity to sell mainline capacity. It is not clear whether this sentence is intended to refer to the open season provisions of the tariff or other provisions permitting Tennessee to reserve capacity. As written, the sentence could be read to provide Tennessee with an unlimited right to reserve capacity to be sold as mainline capacity, which would conflict with Order No. 637. The Commission, therefore, will require Tennessee to amend this provision to read: "Point capacity reserved by the Transporter, *under applicable provisions of this tariff*, to sell generally available mainline capacity to or from the point shall not be available as Segmented Primary Point Capacity.

33. **Proposal 2**:

> Segmented Primary Point Capacity is only available within the Releasing Shipper's capacity path.

34. The Commission denies rehearing on this proposal. In Order No. 637, the Commission found that segmentation could take place at any points within the zone for which the releasing shipper pays. Thus, both the releasing and replacement shippers can choose primary points anywhere within the zone, if capacity is available at the points. However, as discussed above, the primary points selected by the shippers cannot overlap in excess of full contract demand.

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[39] Order No. 637-A, FERC Stats. & Regs. Regulations Preambles ¶ 31,099 at 31,594.

35. The cases cited by Tennessee do not support its contrary contention. In *Kinder Morgan Interstate Gas Transmission*, the Commission on rehearing reversed its decision allowing restrictions on primary points within the path and held that "Kinder Morgan's shippers should be permitted to elect primary points outside the primary path in the same zone subject to the availability of capacity."[40] *Ok Tex Pipeline Co.* is similar, finding that the releasing and replacement shippers can select primary points outside of the original path.[41] In *ANR Pipeline Co.*,[42] and *National Fuel Gas Supply Corp.*,[43] the Commission permitted limitations on segmentation, solely on the reticulated areas of these pipelines. In fact, in *ANR*, the Commission expressly recognized that it was carving out an exception from the general rule that shippers in segmented transactions can choose primary points anywhere within the zone for which they pay:

> [T]his holding is limited to the ANR's reticulated market rate zone. The remainder of ANR's system is not reticulated, and therefore ANR must not only allow outside-the-path segmentation on those parts of its system, but must allow replacement shippers to seek primary points on such segments.[44]

Similarly, in *East Tennessee Natural Gas Co.*,[45] any limitations on segmentation and selection of primary points occurred only on portions of the pipeline which are reticulated and on which segmentation was not required. Tennessee has not shown that its system is so reticulated that an exception from the normal requirements of the Texas Eastern/El Paso policy are warranted.

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[40] Kinder Morgan Interstate Gas Transmission, LLC, 103 FERC ¶ 61,216 at P 17 (2003), *reh'g*, 97 FERC ¶ 61,062 at 61,337 (2001).

[41] 98 FERC ¶ 61,214 at 61,825 (2002).

[42] 104 FERC ¶ 61,320 at P 15-19 (2003).

[43] 96 FERC ¶ 61,182 at 61,808 (2001).

[44] 104 FERC ¶ 61,320 at P 15.

[45] 98 FERC ¶ 61,060 at P 29-42 (2002).

36. **<u>Proposal 3</u>**:

> Segmented Primary Point Capacity is only available at an existing physical point that is classified by Transporter as receipt or delivery point on its system.

37. The Commission denies rehearing with respect to this limitation. The Commission found in Order Nos. 637-A and 637-B that shippers should be able to segment capacity at market centers, pooling points, and other virtual points on the system.[46] Tennessee does not offer an explanation of why segmentation should not be permitted at economically and operationally significant points on its system.

38. **<u>Proposal 4</u>**:

> The Releasing or Replacement Shipper may only create Segmented Primary Point Capacity in the same direction as the Releasing Shipper's contract.

39. The Commission grants rehearing with respect to this proposal. In Order No. 636, the Commission permitted each shipper to change primary points under its existing contract within the zone for which the shipper pays, as long as primary point capacity is available.[47] Tennessee, however, does not sell backhaul service under its firm FT-A rate schedule, but has a firm backhaul rate schedule (Rate Schedule FT-BH) with different rates than forward haul service. Thus, any attempt to change primary points to effectuate a backhaul on Tennessee is not simply a change in primary points under an existing contract, but would require the execution of a new contract for a different service, which Tennessee is not required to permit.[48] Since the replacement shipper and releasing shipper are taking service under the firm FT-A rate schedule, they cannot, as part of a segmented release, change to the backhaul rate schedule. However, the Commission

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[46] Order No. 637-A, FERC Stats. & Regs. Regulations Preambles ¶ 31,099 at 31,591-92 and Order No. 637-B, 92 FERC ¶ 61,062 at 61,165 (2000).

[47] Order No. 636, FERC Stats. & Regs. Regulations Preambles ¶ 30,939 at 30,429 (1992). *See* Tennessee Gas Pipeline Co., 94 FERC ¶ 61,097 at 61,402 (2001), *aff'd*, 292 F.3d 831 (D.C. Cir. 2002) (a change in primary points is a change in contract).

[48] For instance, Tennessee need not permit a shipper with a firm backhaul service at the maximum FT-BH rate to change to a firm primary forward haul service (which has a higher maximum rate).

emphasizes that Tennessee's limitation applies only to changes in primary points; both the releasing and replacement shippers can use their forward haul service to effectuate backhauls on a secondary basis, as required by Order No. 636.[49]

40. **<u>Proposal 5</u>**:

> Segmented Primary Point Capacity is not available for self-releases or segmentation for a Shipper's own use.

41. The Commission grants rehearing on this proposal. The Commission's Texas Eastern/El Paso policy only applies in release transactions where both the releasing and replacement shipper have contracts and can select primary points equal to their respective contract demands. In situations where a shipper is segmenting for its own use (or achieves the same result by a self-release), there is no second contract and the shipper is limited to the primary points in its existing contract.[50]

42. **<u>Proposal 6</u>**:

> Receipt Point Capacity and Delivery Point Capacity on the contract must be equal and cannot exceed the TQ of the Replacement Shipper or the Releasing Shipper.

43. The Commission grants rehearing, and will accept this limitation. The Texas Eastern/El Paso policy only permits the releasing and replacement shippers to select primary points equal to their respective contract demands.[51]

44. **<u>Proposal 7</u>**:

> Segmented Primary Point Capacity is only available for temporary releases. At the end of the release, the terms and conditions of the original contract are in effect unless the contract has been permanently amended. Permanent Primary Point Amendments are

[49] Order No. 636-B, 61 FERC ¶ 61,272 at 61,997 (1992).

[50] *See* Trailblazer Pipeline Company, 103 FERC ¶ 61,074 at P 11 (2003).

[51] Order No. 637, FERC Stats. & Regs. Regulations Preambles ¶ 31,091 at 31,302 (releasing and replacement shipper may reserve primary points "up to its capacity on that segment").

> subject to the applicable provisions of the pertinent rate schedules and the provisions of Article XXVIII, Section 5 of the General Terms and Conditions.

45. The Commission grants rehearing and will accept this provision. The ability to segment capacity only applies to temporary releases. Under Commission policy, a permanent release occurs when a pipeline relieves a releasing shipper of all of its obligations to the pipeline under its service agreement upon the assignment of such obligations to a replacement shipper on a permanent basis (*i.e*., for the remainder of the contact term).[52] Thus, a permanent release requires the full relinquishment of all capacity rights, which cannot occur on a segmented release.

Rate Schedule FT-GS Shippers' Segmentation Rights

46. The July 11 Order clarified that one-part rate FT-GS Rate Schedule customers may segment capacity for their own use by using the flexible point rights provided in their rate schedule (including the use of forward hauls and backhauls) as long as the total volumes delivered do not exceed the delivery limitation under Rate Schedule FT-GS. The order also found that customers with one-part rate schedules could not segment capacity through capacity release as provided in Order No. 636.[53] Tennessee argues that the Commission provided no justification or reasoning for its finding. Tennessee believes the end result will be increased preferential treatment for a class of shippers that already receives preferential treatment. Tennessee also believes that the Commission's finding is at odds with the Commission's finding that in order for Rate Schedule FT-GS customers to achieve full segmentation and capacity release rights, they may convert to a Part 284 firm service with reservation charges.

47. Clarksville requests rehearing of the Commission's denial of its request for overlap segmentation authority (the ability to implement a backhaul and forward haul to a single delivery point that exceeds contract demand). Clarksville contends that the Commission confused a shipper's eligibility for Rate Schedule FT-GS service with limits on the service to be provided under the rate schedule.

48. The Commission grants Tennessee's request for rehearing and denies Clarksville's. Tennessee will not be required to allow FT-GS customers to segment capacity for their own use. This ruling is consistent with the nature of the FT-GS rate

[52] *See* El Paso Natural Gas Co., 61 FERC ¶ 61,333 at 62,312 (1992) (*El Paso*).

[53] 104 FERC ¶ 61,063 at P 143.

schedule, which provides firm service at a volumetric rate for small customers, which is subsidized by Tennessee's other shippers.[54] One-part volumetric rate customers are not paying a reservation charge to reserve capacity. Segmentation, as with capacity release, requires reserved capacity. As the Commission found in Order No. 636-B, shippers that do not pay a reservation charge are not entitled to release capacity.[55] Therefore, small customers' under this rate schedule should not have their rights enhanced by being able to segment capacity.

49. Indeed, to the extent that such use exceeded the 10,000 Dth/day level, the customer should not be eligible to receive the one-part rate. The Commission here is not confusing eligibility with service limitations. A Rate Schedule FT-GS customer's service is limited to 10,000 Dth/day in order to ensure that the subsidized rate is provided only to those small customers that qualify. If such customers could use forward hauls and backhauls to increase their capacity to 20,000 Dth/day, the class of such customers could increase as would the subsidy paid by the other Tennessee customers. Therefore, both the eligibility for the service and the extent of service received by these customers must be limited to 10,000 Dth/day.

<u>Redundant Delivery Point Rights under Capacity Releases</u>

50. National Fuel is a holder of a grandfathered firm transportation agreement with redundant delivery point capacity (primary delivery point rights in excess of National Fuel's mainline contract demand). National Fuel claims that Tennessee informed National Fuel of other capacity release conditions not contained in either the contract or Tennessee's tariff. According to National Fuel, Tennessee informed it that if it released a portion of its grandfathered firm transportation such that the replacement shipper's receipt point transportation quantity equals its delivery point quantity, and the replacement shipper amends the primary delivery point to one not included in the original grandfathered contract, National Fuel would lose its redundant delivery point rights on its remaining contract.[56] National Fuel requests clarification or, in the alternative, rehearing, that grandfathered contracts will not lose redundant delivery point rights simply because a replacement shipper requests a change in primary delivery point(s).

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[54] For this reason, the small customer rate schedule is limited to shippers with contracts under 10,000 Dt/day.

[55] *See* Order No. 636-B, 61 FERC ¶ 61,272 at 61,998 (1992).

[56] National Fuel does not challenge the July 11 Order's finding that released grandfathered firm transportation loses redundant delivery point rights.

51. To begin with, Tennessee cannot impose requirements on shippers that go beyond the scope of its tariff.[57] However, National Fuel misstates the Commission policy when it suggests that replacement shippers can change primary points in their contracts without the releasing shipper running the risk of losing its original primary points.

52. In a number of orders, the Commission has made clear that when replacement shippers change primary points in certain release transactions, the releasing shipper is at risk of losing its primary point rights. The releasing shipper can protect against this risk by placing a condition in the release preventing the replacement shipper from changing points.[58] As the Commission stated in *Natural Gas Pipeline Co. of America*:

> The Commission has explained that if the replacement shipper reserves a different primary point than the one the releasing shipper had, the pipeline is free to sell the releasing shipper's primary point to another shipper. If the releasing shipper wants to ensure that it will still have its original primary point when the released capacity reverts back to it, the releasing shipper may impose a condition in the release that the replacement shipper cannot change the primary points.[59]

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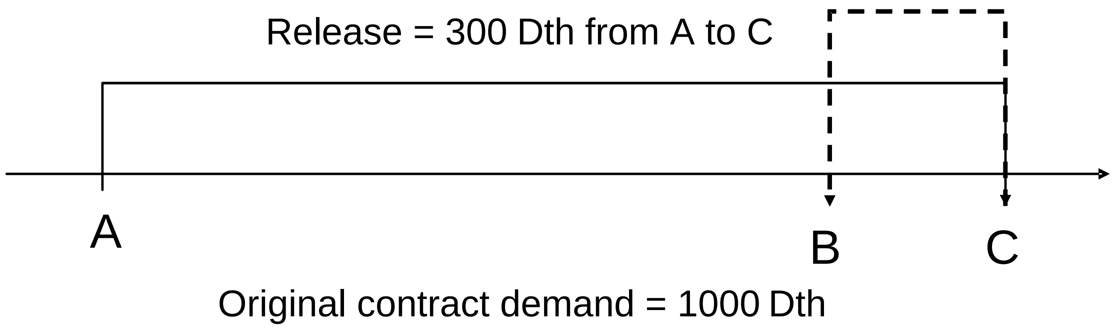
[57] *See* Tennessee Gas Pipeline Co., 95 FERC ¶ 61,272 at 61,959 (2001) (pipelines must act in accordance with their filed tariffs and are not permitted to implement policies through policy manuals or otherwise that are not permitted by its tariff).

[58] *See* Natural Gas Pipeline Co. of America, 101 FERC ¶ 61,200 at P 45 (2002); ANR Pipeline Co., 97 FERC ¶ 61,323 at 62,481 n. 25 (2001); and Trailblazer Pipeline Co., 97 FERC ¶ 61,056 at 61,300 (2001).

[59] Natural Gas Pipeline Co. of America, 101 FERC ¶ 61,200 at P 45 (2002). *See* Midwestern Gas Transmission Co., 101 FERC ¶ 61,310 at P 35 (2002).

53. For example, assume a typical release situation, not a grandfathered delivery point situation, in which a releasing shipper with 1000 Dth of capacity and a primary receipt point at A and a primary delivery point at C releases 300 Dth of that capacity to a replacement shipper.

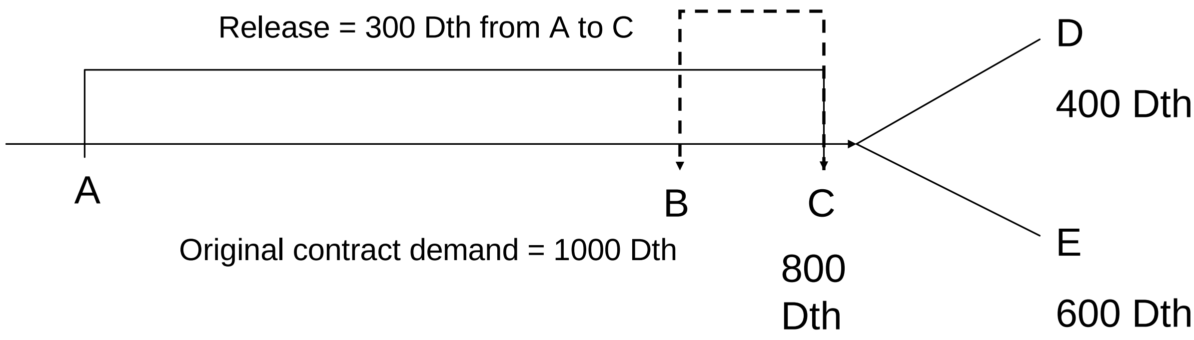


The replacement shipper will have acquired 300 Dth of primary receipt point capacity at receipt point A and 300 Dth of primary delivery point capacity at delivery point C. The releasing shipper would have 700 Dth of mainline capacity remaining, and 700 Dth of primary point capacity at primary points A and C.

54. In this scenario, if the replacement shipper sought to change its primary point to a new delivery point B, upstream of or within the same zone, 300 Dth of primary delivery point rights at point C would no longer be reserved, and the pipeline would be free to sell it to another shipper.[60] To prevent a loss of delivery point rights, the releasing shipper would have to insert a condition in the release preventing the replacement shipper from changing primary points.

[60] If the replacement shipper could change its primary delivery point to B, while the delivery point at C was still reserved on a primary basis, 1300 Dth of primary delivery point rights would be reserved, more than the contract demand of both the releasing and replacement shippers.

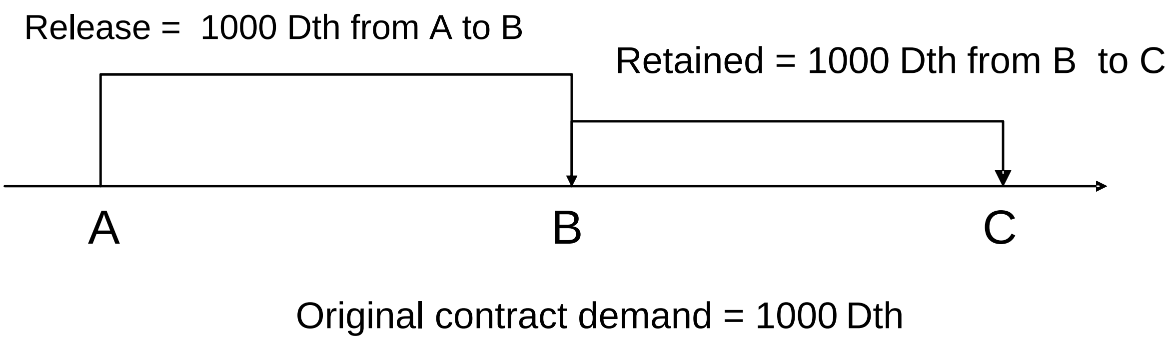
55. This same policy should apply in the case of redundant delivery points. In the following example, the releasing shipper has a contract demand of 1000 Dth with redundant delivery point rights of 1800 Dth. It releases 300 Dth from A to C and the replacement shipper moves its primary delivery point for the 300 Dth from C to B.



56. As the Commission found in the last order, National Fuel cannot release redundant delivery point rights. The replacement shipper, therefore, can only obtain delivery point rights of 300 Dth equal to the contract demand of the release. National Fuel should only be at risk for losing the delivery point rights allocated to the replacement shipper at the particular point should the replacement shipper choose to change primary points (in the example, 300 Dth at point C). Thus, National Fuel will not be at risk of losing its redundant delivery point rights completely in the event the replacement shipper moves its primary point. (It still retains its primary delivery point rights of 400 Dth at Point D and 600 Dth at point E). However, National Fuel would be at risk of losing 300 Dth of primary point rights at delivery point C. National Fuel, however, can protect its primary delivery point at C by including a condition in its release preventing the replacement shipper from changing primary points.[61]

[61] Indeed, the Commission has allowed the pipeline to include in its tariff a default provision that replacement shippers cannot change primary points unless the right is affirmatively granted by the releasing shipper. ANR Pipeline Co., 103 FERC ¶ 61,022 at P 49 (2003).

57. With respect to segmented releases, the same general policy applies, but the need to protect delivery points may be different. For example, National Fuel, with a contract for 1000 Dth of mainline capacity, can release 1000 Dth from its primary receipt point A to a secondary point B, while retaining 1000 Dth of capacity from point B to primary delivery point C.



58. In this example, the replacement shipper can choose a primary delivery point at B (if capacity at this point is available). As discussed above, such a segmented transaction is one that the pipeline could have made when it provided a bundled sales service, and, therefore, in order to ensure that capacity release can compete on an equal footing with pipeline service, the replacement shippers is given the right to choose point B as a primary delivery point as long as capacity is available at that point. By the same token, National Fuel will be retaining its full delivery point capacity at point C (as well as its redundant delivery points), and therefore will not be at risk for losing delivery point capacity.[62]

[62] However, if National Fuel wants to retain its primary receipt point at A, it would have to include a condition preventing the replacement shipper from changing that point. *See* Regulation of Short-Term Natural Gas Transportation Services, Notice of Proposed Rulemaking, FERC Stats. & Regs. Proposed Regulations ¶ 32,533 at 33,452 n. 52 (1998) (if the replacement shipper seeks to change its primary receipt point right from the Gulf to another point, then the releasing New York shipper might lose the ability to return to its primary Gulf receipt point at the end of the release).

Unscheduled Flow Penalties Should Apply to Non-Rate Schedule LMS-PA Receipt Points

59. The July 11 Order required Tennessee to remove its penalty for flowing gas which has not been scheduled.[63] Tennessee explains that it has receipt points not covered by an OBA under Rate Schedule Load Management Service – Pooling Area (LMS-PA). Therefore, for those receipt points not covered by OBA under Rate Schedule LMS-PA, Tennessee desires to continue to apply the unscheduled flow penalty.

60. The Commission grants Tennessee's request to continue to apply the unscheduled flow penalty to those receipt points not covered by an OBA and not subject to the imbalance provisions of Rate Schedule LMS-PA. Shippers whose receipt points lack an OBA and are not subject to Rate Schedule LMS-PA's imbalance provisions should be held accountable for unscheduled flows.

CIG/Granite State Discount Policy

61. The July 11 Order denied Tennessee's request for rehearing of the Commission's application of the *CIG/Granite State*[64] discount policy to Tennessee.[65] Tennessee requests rehearing of the denial of its request for rehearing. Tennessee states that as a result of the risks and unknown consequences of the Commission's actions, Tennessee has reduced its willingness to offer discounts. The Commission, Tennessee contends, is effectively requiring discounts beyond the approved justification for discounts - that they help the system as a whole - without support. Tennessee contends that the CIG/Granite State discount policy acts contrary to Commission statements that discounted shippers bring new load to the system resulting in net benefits to maximum rate shippers. Tennessee submits that the Commission ignored Tennessee's examples showing that discounts could harm a maximum rate shipper's competitive status by increasing the preference given discounted shippers, giving the discounted shipper an advantage in the capacity release market, and reducing Tennessee's current revenue stream from discounting. Tennessee also claims the Commission ignores the harm to maximum rate shippers through the loss of interruptible capacity sales.

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[63] 104 FERC ¶ 61,063 at P 184.

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

[65] 104 FERC ¶ 61,063 at P 45-58.

62. Tennessee argues that the Commission statement that it needs to apply the CIG/Granite State policy to existing contracts to prevent undue discrimination is not supported. Tennessee insists that prior to the Commission's change in policy shippers at a secondary point would not have been considered similarly situated. Tennessee asserts that the Commission admits to modifying existing discounts entered into under the old policy. Tennessee requests that the Commission grant rehearing to not apply the CIG/Granite State policy to Tennessee. In the alternative, Tennessee requests that the policy should not apply to existing contracts.

63. To address the decision in *Williston*[66] vacating the application of the CIG/Granite State policy to Williston and the Commission's concerns regarding the appropriate relationship between its selective discounting policy and the competitive measures adopted in Order Nos. 636 and 637, the Commission has established a generic proceeding to examine its discounting policy in the Commission Notice of Request for Comments; and Order on Remand issued June 1, 2004 in Docket No. RP00-463-008.[67] Therefore, the Commission desires more data related to Tennessee's discounted transactions before it makes a determination on the appropriateness of applying the CIG/Granite State policy to Tennessee. Accordingly, Tennessee is directed to submit data responses to the following question within 30 days of the date of issuance of this order.

1. How many discounted contracts does Tennessee have at this time?

2. How many discounted firm service contracts did Tennessee enter into in the past year? What was the volume of gas Tennessee transported under each of those contracts in the past year? What was the term of each contract? What were the receipt and delivery points under each contract? Explain the benefits to system management that resulted from each discount. To the extent that any of these discounts were intended to increase flows on particular parts of the system, identify each discount and explain on what parts of the system the discount was intended to increase flow.

3. How many requests for discounted firm service did Tennessee reject in the past year? What was the reason for the rejection of each transaction? How many of the rejected transactions were consummated without a discount?

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[66] Williston Basin Interstate Pipeline Co. v. FERC, 358 F.3d 45 (D.C. Cir. 2004).

[67] Williston Basin Interstate Pipeline Co., 107 FERC ¶ 61,229 (2004).

4. How many of the discounted firm service contracts Tennessee entered into in the past year would it have refused to enter into if the CIG/Granite State policy was imposed? If you would have refused, please explain why Tennessee would have preferred to lose the increased throughput and revenue. Please identify to which points Tennessee feared the discounts would migrate. Was Tennessee already giving discounts at those points?

5. How many non-discounted IT service contracts did Tennessee enter into in the past year and what was the volume of gas Tennessee transported under those contracts?

6. How many discounted interruptible service contracts did Tennessee enter into in the past year? What was the volume of gas Tennessee transported under each contract? What were the terms and receipt and delivery points under each contract?

7. What was the total revenue Tennessee received from its non-discounted IT contracts and the total revenue received from its discounted IT contracts in the past year?

8. If the CIG/Granite State policy were revised to apply only in the case of releases of 31 days or less, would such a revision have less of an effect on the granting of firm discount contracts? Explain the answer.

Penalty Revenue Crediting

64. The July 11 Order found, among other things, that Tennessee must revise its penalty revenue crediting mechanism to include balancing parties.[68] Further, the order clarified that to the extent that there are shippers at points not governed by OBAs, or shippers behind OBAs individually subject to paying penalties, Tennessee must include such shippers in any penalty credit. The determination in the July 11 Order was partially based on the Commission’s order in Tennessee’s Docket No. RP02-114-001 rejecting

[68] 104 FERC ¶ 61,063 at P 100.

Tennessee's proposal to provide refunds from cashout and imbalance penalties to long-term firm customers.[69] As the order in that docket was pending rehearing, Tennessee was required to make conforming changes to its proposal here to reflect the final outcome of that proceeding.[70]

65. The Indicated Shippers request clarification or rehearing that, if the Commission modifies the cash-out revenue crediting in Docket No. RP02-114, the Commission will independently review any future filing Tennessee makes in this proceeding, and parties to the instant proceeding may raise any issue relevant to such future filing in this proceeding (including the applicability of the holdings on rehearing in Docket No. RP02-114 to the penalty revenue crediting mechanism in this proceeding). Indicated Shippers argue that, while the cash-out refund issues in Docket No. RP02-114 are similar, they are not identical. As Docket No. RP02-114 is not consolidated with this docket, Indicated Shippers do not wish to be caught in a procedural position that would foreclose parties in this proceeding from protesting or seeking rehearing of any future change in the penalty revenue crediting mechanism in this proceeding.

66. The Commission will grant Indicated Shippers' request for rehearing, in part, and finds that all issues relating to crediting of cashouts will be resolved in Docket No. RP02-114, and no further filings relating to cashout crediting will be needed in this docket. In addition, the Commission will require Tennessee to make a compliance filing that delineates in a separate provision of the tariff how penalty revenue credits will be managed separate and apart from the cashout revenue that is the subject of Docket No. RP02-114.

67. The Docket No. RP02-114 proceeding is examining, in full, Tennessee's pre-existing crediting mechanism for cashouts, based on a settlement. Under these provisions, cashout revenue was used to reduce take-or-pay charges, and the Commission is issuing an order on this proceeding concurrently with this order. All issues relating to cashout crediting, including Order No. 637 compliance, are being addressed in the Docket No. RP02-114 proceeding and need not be further addressed in this proceeding.

68. All other issues relating to crediting of other penalties should be treated separately from the cashout crediting and resolved in this proceeding. In this respect, the Commission is not sure whether there are parts of Tennessee's tariff that may

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[69] Tennessee, 105 FERC ¶ 61,367 (2003). An order on rehearing is being considered contemporaneously with this order.

[70] 104 FERC ¶ 61,063 at P 102.

inappropriately mix the cashout crediting mechanism with crediting for other penalties.[71] Accordingly, Tennessee is required to make a compliance filing that explains whether there is any overlap between these provisions and, if necessary, include revised tariff sheets that ensure that non-cashout other penalty revenues that are subject to the penalty revenue crediting mechanism proposed at Article XXXVIII of Tennessee's General Terms and Conditions are not included in the cashout mechanism. Indicated Shippers' request of rehearing is granted to the extent that the cashout revenue crediting mechanism is no longer at issue in this proceeding; and the cashout revenue crediting mechanism will be reviewed only in Docket No. RP02-114.

Compliance Filing

69. On August 11, 2003, Tennessee filed in compliance with the July 11 Order. Tennessee states that, while it is filing in compliance with the Commission's orders, it continues to reserve its rehearing and appeal rights. Details of the compliance filing are described below.

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[71] For example, Article XXXVIII, as proposed in Tennessee's compliance filing in Docket No. RP00-477-003 and continued in Docket No. RP00-477-005, states that

> From the total amount of penalty charges collected, all amounts related to revenues or costs incurred by Transporter as a result of having to purchase, confiscate or sell gas, … related to penalties reference in this Article XXXVIII, shall be credited to the cashout mechanism … pursuant to Section 7(g)9(i) of Rate Schedule LMS-MA.

This section may have been appropriate given the time the proposal was made. However, given the current status of the Docket No. RP02-114 proceeding, it is not clear whether cashouts in Rate Schedule LMS-MA are defined to include gas related costs incurred from other penalties referenced in Article XXXVIII. If these costs are not part of the Docket No. RP02-114 proceeding, they should not be made part of the cashout revenue crediting mechanism.

Notice, Interventions, Comments and Protests

70. Notice of Tennessee's compliance filing was issued on August 14, 2003, providing for the filing of interventions and protests by August 25, 2003. Pursuant to Rule 214, 18 C.F.R. § 385.214 (2003), all timely filed motions to intervene are granted. Several Parties protested Tennessee's compliance filing.[72] The protests raise issues discussed below.

Segmentation

71. The July 11 Order required Tennessee to delete or modify tariff proposals that could have: (1) conflicted with shippers' rights to use flexible point rights outside the path but within the zone for which the shipper pays; (2) precluded shippers from using their extended transportation service to access points on a lateral; and (3) defined both forward haul and backhaul segments to a single point as out of the path.[73]

72. Tennessee believes the Commission erred by confusing the definition of "transportation path" in its tariff with the more restrictive definition of "capacity path." Tennessee proposes clarifying language to reflect that a shipper may segment between a primary receipt and primary delivery point or between two points in the zone(s) for which the shipper has paid, and includes the right to extended delivery service to access points on an incremental lateral. Tennessee also removed language providing that nominations that result in an overlap of contract quantities at a point will be considered out of the path for location restriction purposes. Tennessee also proposed language stating that a shipper may exceed its capacity entitlements at a point if the resulting overlap of contract quantities consists of a forward haul up to capacity entitlement and back haul up to capacity entitlement.

73. The July 11 Order also required Tennessee to permit replacement and segmented capacity shippers to seek to upgrade secondary points to primary points, and required Tennessee to treat these shippers no differently than existing shippers requesting primary points.[74] Tennessee states that it interprets these requirements as requiring only that third

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[72] Protests or comments were filed by Clarksville, Indicated Shippers, Natural Fuel Gas Distribution Corporation and, Rhode Island State Energy Statutory Trust 2000.

[73] 104 FERC ¶ 61,063 at P 135, 136, 140.

[74] 104 FERC ¶ 61,063 at P 20, 27 and 147.

party replacement shippers may obtain available primary point capacity. The proposed tariff language also provides that segmented primary point capacity is available only if capacity is generally available and won through an open season, and, if the original contract is not permanently amended, the primary points revert back to the original primary points at the end of the release term. Tennessee also believes the July 11 Order required Tennessee to change its tariff language to remove restrictions on resegmenting of segmented primary point capacity. Tennessee clarifies that its tariff does permit resegmentation; the tariff simply provides that the replacement shipper must abide by any terms of the release that may restrict segmentation.

74. The July 11 Order further required Tennessee to permit Rate Schedule FT-GS customers with flexible receipt point rights, and flexible delivery points rights to storage capacity to segment their capacity.[75] Tennessee interprets this requirement to mean that Rate Schedule FT-GS customers cannot segment and/or overlap at a point in excess of total contract levels of either receipts or deliveries. Further, Tennessee proposes to limit FTS-GS customer's total deliveries to10,000 Dth/day.

Protests

75. Clarksville, in addition to the points it raised on rehearing, also requests that the Commission require Tennessee to include specific language that permits Rate Schedule FT-GS customers who exercise their forward haul and backhaul point overlap rights to exceed their contract demands at that point.

76. National Fuel protests Tennessee's proposed restriction on existing firm shippers' rights to request elevation of segmented capacity point rights from secondary to primary through self releases or segmentation for a shipper's own use. National Fuel argues that Order No. 637 required pipelines to permit shippers to segment their capacity for their own use or for release, and that the July 11 Order found that if there is firm primary point capacity available, it must be offered to all potential shippers on a non-discriminatory fashion. National Fuel argues that the words potential shippers include existing shippers.

77. Rhode Island protests Tennessee's proposal not to permit releasing shippers to market capacity at primary points that Tennessee has reserved for future use. Rhode Island requests that the Commission require Tennessee to remove the condition that point capacity reserved by Tennessee to sell generally available mainline capacity to or from the point shall not be available as segmented primary point capacity.

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[75] 104 FERC ¶ 61,063 at P 143.

Commission Response

78. Tennessee's tariff revisions are accepted as in compliance with the July 11 Order, subject to Tennessee refiling tariff sheets to reflect revisions occasioned by the Commission's grant of rehearing on several aspects of segmentation.

79. The Commission, however, finds that one aspect of Tennessee's compliance filing is not in accord with the Texas Eastern/El Paso policy, as described above. In section 11.11(o) of its compliance filing, Tennessee proposed the following limitation on segmented releases:

> Transporter may, at its option, post as generally available capacity any Segmented Primary Point Capacity at a particular point that was not utilized by the Releasing or Replacement Shipper for a consecutive thirty day period, provided that the Releasing or Replacement Shipper will retain that point as a Secondary Receipt or Delivery Point on its contract.

80. This provision is contrary to Order No. 637 and the Texas Eastern/El Paso policy. Under that policy, the releasing and replacement shippers can choose primary points equal to their contract demand with the same rights as any other shipper. Other shippers holding firm primary point capacity are not subject to losing those primary points if they are not used.

81. Tennessee has failed to justify this limitation. As described in the rehearing section, Tennessee has sufficient protection against hoarding of receipt or delivery point capacity that such a further restriction is not needed to prevent hoarding or protect its ability to market capacity. Such a provision also will provide an advantage to obtaining capacity from the pipeline, which the Texas Eastern/El Paso policy was designed to prevent. If a shipper obtains pipeline primary point capacity, it is under no obligation to use that capacity or lose its primary point, whereas under Tennessee's proposal, a shipper taking a segmented release would be subject to losing its primary point.

82. Moreover, a use-or-lose provision will unduly limit a replacement shipper's ability to use its flexible receipt and delivery point authority. For example, suppose the replacement shipper obtains segmented capacity for a 6 month period and chooses the primary point it wishes to use. However, for one month, the shipper wants to use that capacity to serve another point on a secondary basis. Under Tennessee's proposal, such a use of capacity would result in the shipper losing its primary point, and, in effect, limit its rights to use flexible receipt and delivery points.

83. National Fuel's protest regarding granting of primary points when a shipper segments for its own use is denied. As explained above, the Texas Eastern/El Paso policy applies only to released capacity.

84. The Commission partially agrees with Rhode Island's protest. Tennessee has the right to reserve capacity for future expansion projects.[76] The July 11 Order did not change this right. The July 11 Order simply provides that, to the extent primary point capacity is available, it must be offered to all shippers on the same basis without distinction as to class of customer. Above the Commission found that Tennessee must clarify its tariff to limit capacity reservations to those provided in its tariff.[77] However, the Commission denies Rhode Island's request to permit releasing shippers to acquire additional primary points for segmented capacity. Tennessee is not required to permit primary point capacity in excess of original contract levels.[78]

85. The Commission denies Clarksville's request that the Commission require Tennessee to permit Rate Schedule FT-GS customers who exercise forward haul and backhaul point overlap rights to exceed their contract demands at that point. The Commission granted Tennessee's request for rehearing of segmentation rights granted Rate Schedule FT-GS shippers in the July 11 Order. This action leaves Rate Schedule FT-GS at its current status of not permitting capacity release or segmentation for one-part rate shippers. Overlapping receipt and delivery point rights cannot occur in the absence of segmentation.

Mainline Priority

86. The July 11 Order, in granting rehearing on the issue of deleting tertiary priority, found Tennessee's mainline priority proposal for shippers using secondary points within their capacity path consistent with the objectives of Order No. 637.[79] Tennessee states that in preparation for the instant compliance filing, it found an additional provision of its tariff that requires modification to implement the approved mainline priority

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[76] Section 5.8 of its GT&C, as discussed and approved at Tennessee Gas Pipeline Co., 82 FERC ¶ 61,288 (1998), 84 FERC ¶ 61,304 (1998), and 86 FERC ¶ 61,066 (1999).

[77] *See* the Commission's discussion of "Proposal 1" above.

[78] *See* the Commission's discussion of "Proposal 5" above.

[79] 104 FERC ¶ 61,063 at P 37 through 44.

methodology. Tennessee believes that Article III, Section 5(a) of its General Terms and Conditions (GT&C) must be modified to clarify that a capacity releaser does not retain in-the-path priority through a released segment in its primary path if there is a point of restriction on the segment that it released, since the capacity releaser no longer has capacity on that portion of the path. The in-the-path priority for the segment goes with the released capacity to the replacement shipper.

87. We will accept this provision as being just and reasonable, although such clarification may not have been necessary. The Commission does not see any situation where transportation of gas by a shipper over a segment on which the shipper has no remaining contract capacity would be considered a within-the-path transaction.

Discount Provisions

88. As discussed earlier, the Court of Appeals for the District of Columbia Circuit has vacated the Commission's order in *Williston* requiring pipelines to conform to the CIG/Granite State policy. In this order, the Commission has established provisions to consider whether to apply this policy to Tennessee. Accordingly, Tennessee will not be required to implement this policy at this time.

Penalty Provision Revisions

89. The July 11 Order directed Tennessee to make several minor changes to its penalty provisions. These changes included: requiring that the new Action Alert penalty should be no greater than the existing penalty; that the index price for excess storage withdraws should be the average of the weekly spot prices, not the daily spot price; that Tennessee should retain the existing 1,000 Dth tolerance for small customers or explain why Tennessee can no longer provide it; that Tennessee should provide notice of when its net system imbalance was approaching the point when it would assess Daily Imbalance Charges; and that Tennessee must remove its unscheduled flow provision from its tariff.

90. Tennessee proposes an Action Alert penalty of twice the Rate Schedule PAL rate. The resulting penalty will be lower than the existing Action Alert penalty. Tennessee also proposes tariff language that revises the index price to reflect the weekly spot price, provides for a 1,000 Dth absolute tolerance for the Daily Imbalance Charge, and provides notice to shippers and OBA point operators when its net system imbalance exceeds 4.5 percent.

91. Tennessee does not propose to remove its unscheduled flow provision. However, Tennessee removes balancing parties from its definition of responsible parties in Article III, Section 8.2 of its GT&C, since imbalances at points with an OBA should be covered under the OBA. As the provision is now limited to non-OBA points, Tennessee

proposes to revoke the 500 dth/d tolerance. Tennessee explains that, while imbalances on the receipt side are covered for points with an OBA, not all receipt points are covered by an OBA. For receipt points not covered by an OBA, Tennessee asserts, it needs to retain the unscheduled flow provision. Alternatively, Tennessee proposes to deem a shipper that flows unscheduled gas to have signed an OBA at that point to which the imbalance may be allocated. Absent the PAL or OBA alternative, Tennessee states it has no other option than to retain unscheduled gas.

Protests

92. Indicates Shippers protest part of Tennessee's Action Alert penalty proposal. While they do not object to Tennessee's proposal to charge a Load Management Service-Market Area (LMS-MA) Action Alert penalty of twice the Rate Schedule PAL rate, they object to an LMS-PA Action Alert penalty at that level. Indicated Shippers note that Tennessee's proposed Action Alert penalty for Rate Schedule LMS-PA would increase the penalty from $0.2198 per dth to $0.7872 per dth. Indicated Shippers assert that this is a penalty rate increase contrary to the Commission's July 11 Order.

Commission Response

93. The Commission finds that Tennessee complied with the July 11 Order penalty requirement provisions with two exceptions. First, as discussed in the rehearing section of this order, the Commission granted rehearing in part. Tennessee may retain the unscheduled flow penalty provisions as revised.

94. Second, Tennessee's proposal to apply twice the Rate Schedule PAL rate to Action Alert penalties applicable to Rate Schedule LMS-PA is contrary to the July 11 Order. As stated in the July 11 Order and discussed in the April 3 Order, compliance with Order No. 637 is not an opportunity for pipelines to increase penalties.[80] Accordingly, Tennessee is directed to maintain the Action Alert penalty for Rate Schedule LMS-PA at $0.2198 per Dth. This finding is without prejudice to Tennessee making a section 4 filing that may change this Action Alert penalty rate on a prospective basis. Tennessee is directed to file to revise Fourth Revised Sheet No. 360 with the appropriate penalty.

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[80] *See* Texas Eastern Transmission, LP, 102 FERC ¶ 61,198 at P 97-106 (expansion of penalties beyond scope of compliance with Order No. 637).

Penalty Revenue Crediting

95. The July 11 Order required the following revisions to Tennessee’s proposed penalty revenue crediting mechanism. Balancing parties were to be included as recipients of penalty credits, as they are subject to imbalance penalties. Eligible shippers for penalty revenues were to include shippers whose contracts terminated during the penalty crediting period. Rate schedules liable to OFO penalties have to be included in the penalty revenue crediting mechanism. Tennessee was to include tariff provisions providing for accruing of interest on penalty revenues. The July 11 Order also required Tennessee to provide penalty credits within 60 days of the close of the annual crediting period.

96. Tennessee filed tariff language to comply with the Commission’s direction. Tennessee proposes language that credits penalty revenues to shippers at non-OBA points and balancing parties on the basis of scheduled quantities. Tennessee clarifies that for Rate Schedule SA volumes, only the scheduled volumes at physical points at which the SA agreement is performing the balancing function would count; otherwise the result would be to count multiple times the same physical receipt of gas. In order to credit only non-offending shippers, Tennessee proposes that in any month that a shipper or OBA holder incurred a penalty, it would not have any scheduled volumes for that month included in the determination of the allocation percentage. Tennessee also proposes that any adjustments would be rolled forward to the following year. Tennessee’s filing complies with the July 11 Order on this issue.

Operational Flow Orders

97. The July 11 Order required Tennessee to add the words "as nearly as practicable" to its OFO hourly flow restrictions related to all of the listed rate schedules except Rate Schedule NET. The Commission stated that this would make the OFO hourly flow restriction consistent with the restrictions in the listed rate schedules and ensure that service under the listed rate schedules is not degraded. Tennessee was also required to add the phrase, "under one or more of the above-listed rate schedules" to sections 4.4 and 5 of its GT&C. Tennessee filed tariff sheets reflecting the required changes.

98. However, as discussed earlier, the Commission has granted rehearing with respect to the hourly flow limitations in Tennessee’s tariff. Tennessee therefore will need to file revised tariff sheets to reflect this change.

Effective Date

99. The July 11 order accepted certain tariff sheets from Tennessee's Docket No. RP00-477-003 filing effective September 1, 2003, subject to Tennessee filing tariff sheets reflecting modified tariff language.[81] Tennessee, in the instant compliance filing, refiled tariff sheets accepted without a further compliance obligation and requested an October 1, 2003 effective date. These sheets were identified on Tennessee's Appendix B. Tennessee states that it requires additional time to implement various aspects of the new tariff provisions. In addition, for tariff sheets refiled to comply with the July 11 Order, Tennessee also proposed an October 1, 2003 effective date for all but one tariff sheet. For First Revised Sheet No. 339B, Tennessee requested an effective date of April 1, 2004, as Tennessee did not wish to implement the proposed change during the winter season.

100. With the exception of Sheet No. 339B, the Commission grants Tennessee's request for an extension of time to implement the tariff sheets accepted effective September 1, 2003 in the July 11 Order, and accepts the tariff sheets identified on the Appendix of this order effective October 1, 2003. First Revised Sheet No. 339B is accepted effective April 1, 2004.

The Commission orders:

(A) The requests for rehearing are accepted or denied as discussed in the body of this order.

(B) Tennessee's proposed compliance tariff sheets are accepted as of the dates shown on the Appendix of this order.

(C) Tennessee is required to file revised tariff sheets as discussed in the body of this order within 30 days of the date of this order.

[81] 104 FERC ¶ 61,063 at Ordering Paragraph B.

(D) Tennessee is directed to file data responses to questions addressing all compliance issues as discussed in the body of this order within 30 days of the date of this order.

By the Commission. Commissioner Kelly not participating.

(S E A L)

Magalie R. Salas,
Secretary.

Appendix

List of Tariff Sheets
Accepted October 1, 2003, unless otherwise noted.

Tennessee Gas Pipeline Company
FIFTH REVISED VOLUME NO. 1
First Revised Sheet No. 20A
First Revised Sheet No. 23A.01
First Revised Sheet No. 23C.01
First Revised Sheet No. 23E.01
First Revised Sheet No. 26B.01
Eighth Revised Sheet No. 28
Fifth Revised Sheet No. 95B
Sixth Revised Sheet No. 100
Fourth Revised Sheet No. 101
Fourth Revised Sheet No. 106
Second Revised Sheet No. 110A
Sixth Revised Sheet No. 153
Fourth Revised Sheet No. 155
Tenth Revised Sheet No. 161
Fifth Revised Sheet No. 162
Second Revised Sheet No. 162A
Second Revised Sheet No. 165A
Eleventh Revised Sheet No. 167
Sixth Revised Sheet No. 168
Tenth Revised Sheet No. 173
Fourth Revised Sheet No. 174
Third Revised Sheet No. 202
Sixth Revised Sheet No. 203
Tenth Revised Sheet No. 204
Ninth Revised Sheet No. 205
Ninth Revised Sheet No. 205A
Sixth Revised Sheet No. 205B
Ninth Revised Sheet No. 206
Eighth Revised Sheet No. 207
Sixth Revised Sheet No. 207A
Tenth Revised Sheet No. 209
Second Revised Sheet No. 209.01
Sixth Revised Sheet No. 209B
Fifth Revised Sheet No. 209C

Fifth Revised Sheet No. 209D
Fourth Revised Sheet No. 209E
Fifth Revised Sheet No. 209F
Fifth Revised Sheet No. 209I
Fifth Revised Sheet No. 210
Sixth Revised Sheet No. 211
Fifth Revised Sheet No. 211A
Tenth Revised Sheet No. 212
Sixth Revised Sheet No. 213
Fifth Revised Sheet No. 216
Seventh Revised Sheet No. 217
Fifth Revised Sheet No. 219A
Fifth Revised Sheet No. 228
Third Revised Sheet No. 229
Fifth Revised Sheet No. 234
Second Revised Sheet No. 235
Second Revised Sheet No. 236
Third Revised Sheet No. 240
Second Revised Sheet No. 241
Twelfth Revised Sheet No. 301
Sixth Revised Sheet No. 304
Fourth Revised Sheet No. 304A
Thirteenth Revised Sheet No. 305
First Revised Sheet No. 305A
Seventh Revised Sheet No. 314B
Eighth Revised Sheet No. 314C
Thirteenth Revised Sheet No. 315
Twelfth Revised Sheet No. 316
First Revised Sheet No. 316A
Twelfth Revised Sheet No. 317
Eleventh Revised Sheet No. 318
Ninth Revised Sheet No. 319
Eighth Revised Sheet No. 319A
Sixth Revised Sheet No. 339A
First Revised Sheet No. 339B *
Seventh Revised Sheet No. 357
Fifth Revised Sheet No. 358
Fourth Revised Sheet No. 359
Fourth Revised Sheet No. 360
Second Revised Sheet No. 360A
Third Revised Sheet No. 361

First Revised Sheet No. 361A
Sixth Revised Sheet No. 406
Sixth Revised Sheet No. 406A
Fourth Revised Sheet No. 406B
Second Revised Sheet No. 414
First Revised Sheet No. 415
First Revised Sheet No. 416
Third Revised Sheet No. 587
Fourth Revised Sheet No. 588
Third Revised Sheet No. 596
First Revised Sheet No. 597
Fourth Revised Sheet No. 605
First Revised Sheet No. 606
Second Revised Sheet No. 613

* Accepted effective April 1,2004