UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Columbia Gulf Transmission Company Docket No. RP06-49-001

ORDER ON REHEARING

(Issued May 2, 2006)

1. On December 23, 2006, Indicated Shippers[1] filed a request for rehearing of the Commission's November 23, 2005 Letter Order (November 23 Order).[2] The November 23 Order accepted revised tariff sheets filed by Columbia Gulf Transmission Company (Columbia Gulf) to modify its penalties for unauthorized overruns, violations of an operational flow order (OFO), and failure to comply with an order to interrupt service. Columbia Gulf proposed to replace its existing fixed price penalties with penalties based on three times a daily index price. For the reasons discussed below, the Commission denies the request for rehearing of the November 23 Order.

Background

2. As adopted in Order No. 637,[3] section 284.12(b)(2)(v)[4] of the Commission's regulations provides in part that:

> A pipeline may include in its tariff transportation penalties only to the extent necessary to prevent the impairment of reliable service. Pipelines

[1] Indicated Shippers consists of BP American Production Company and BP Energy Company, Chevron U.S.A. Inc., ConocoPhilllips Company, ExxonMobil Gas and Power Marketing Company (A Division of ExxonMobil Corporation) and Shell Offshore Inc.

[2] 113 FERC ¶ 61,204 (2005).

[3] *Regulation of Short-Term Natural Gas Transportation Services and Regulation of Interstate Natural Gas Transportation Services, Order No.637, FERC Stats. and Regs., Reg. Preambles [1996-2000]* ¶ 31,091 (Order No. 637).

[4] 18 C.F. R. §284.12(b)(2)(v)(2005).

may not retain net penalty revenues, but must credit them to shippers in a manner to be prescribed in the pipeline's tariff.

3. In its October 25, 2005 filing in this proceeding, Columbia Gulf proposed to revise the penalty provisions in section 19 of its General Terms and Conditions (GT&C). The penalty provisions at issue are the following: First, existing section 19.1 of the GT&C of Columbia Gulf's tariff provides that if a shipper takes gas in excess of 103 percent of its Total Firm Entitlements (TFE) within a zone on any Day, Columbia Gulf shall assess a penalty of $10.00 per Dth. Section 19.1 of the GT&C also provides that this unauthorized overrun penalty will be waived if the unauthorized overrun does not cause an operational problem. Second, section 19.2 of the GT&C provides for a penalty if a shipper fails to interrupt service when ordered to do so by the pipeline pursuant to section 16 of the GT&C, Interruptions of Service.[5] Specifically, if the shipper delivers or takes gas in excess of 103 percent of the sum of the lowered Scheduled Daily Receipt Quantity or lowered Scheduled Daily Delivery Quantity in the interruption order, Columbia Gulf assesses a penalty of $5.00 per Dth on the first three percent of the excess quantities, and $10.00 per Dth for quantities in excess of 103 percent. Finally, section 19.3 of the GT&C provides that if a shipper fails to comply with an OFO issued by the pipeline pursuant to

[5] Section 16.1(a) provides, in part, that:

> If due to force majeure, other unforeseen conditions on Transporter's system, or operating conditions (such as, but not limited to, performing routine maintenance, making modifications, tests or repairs to Transporter's pipeline system or protection of the integrity and performance capability of its facilities), the gas available for delivery from Transporter's system or portion thereof is temporarily insufficient to meet all of Transporter's authorized firm services on any day, then Transporter, upon providing as much notice as possible, shall interrupt all such services in accordance with the priorities set forth at Section 16.4 below.

section 17, Operational Flow Orders, of the GT&C,[6] a penalty of $5.00 per Dth per day will be assessed on all quantities taken or delivered in violation of that OFO.

4. The Commission reviewed all these penalties in Columbia Gulf's Order No. 637 compliance proceeding,[7] and found that each of these penalties penalizes conduct that is appropriately subject to the substantial penalties under Order No. 637. In its October 25, 2005 filing, Columbia Gulf did not propose to modify the conduct to which these penalties apply. It proposed only to modify the level of these penalties. Specifically, Columbia Gulf proposed to replace the existing fixed level of these penalties with penalties equal to three times the midpoint of the range of prices reported for "Columbia Gulf, Louisiana" published in the daily price survey by Platts *Gas Daily* for the day on which the penalty was incurred.

<u>The November 23 Order</u>

5. In the November 23 Order, the Commission found that Columbia Gulf's proposed change in the level of the subject penalties is reasonable. The Commission stated that it has consistently approved high penalties to deter conduct that might threaten pipeline operations. The Commission further stated that given the current increased gas prices and the potential for prices to continue rising, Columbia Gulf could reasonably conclude that its current fixed penalties may no longer act as an effective deterrent to actions that might threaten pipeline operations. The Commission noted that Columbia Gulf's proposed penalty provisions, based on multiples of price indices, are similar to others the Commission has approved and found to be just and reasonable. Finally, the Commission pointed out that penalty revenues are credited to the shippers who abide by Columbia Gulf's tariff.

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[6] Section 17.1(a) provides, in part, that:

> Transporter, in its reasonable discretion, shall have the right to issue Operational Flow Orders (OFO) as specified in this section upon determination by Transporter that action is required in order to alleviate conditions which threaten the integrity of Transporter's system, to maintain pipeline operations at the pressures required to provide reliable firm transportation services, to have adequate supplies in the system to deliver on demand (including injection of gas into the mainline and providing line pack), to maintain firm service to all Shippers and for all firm services, and to maintain the system in balance for the foregoing purposes. To the extent feasible, Transporter shall attempt to direct such OFOs to those shippers causing the condition that necessitates issuance of the OFO.

[7] 100 FERC ¶ 61,344 (2002) and 104 FERC ¶ 61,035 (2003).

The Request for Rehearing

6. In its request for rehearing of the November 23 Order, Indicated Shippers argues that the Commission's acceptance of Columbia Gulf's proposed penalty increases contravened the regulatory policy enunciated in Order No. 637 and the Commission's regulations which state that "a pipeline may include in its tariff transportation penalties only to the extent necessary to prevent the impairment of reliable service."[8] Indicated Shippers further argues that the Commission's finding that the proposed penalty increase is just and reasonable is unsupported. Indicated Shippers contends that Columbia Gulf presented no operational data or other explanation and that it is unclear whether the proposed penalties are just and reasonable or whether they will trigger the filing of penalty increases by other pipelines. Indicated Shippers asserts that Columbia Gulf cites no examples of OFO, unauthorized overrun, or failure to interrupt violations, shipper behavior or operational stress on its system, or potential adverse impacts on flexibility and competition. Indicated Shippers further asserts that the Commission appears to presuppose that only parties engaged in price arbitrage are penalized. Indicated Shippers contends that the Commission should direct Columbia Gulf to make a supplemental filing to provide support for the proposal and that a technical conference should be convened to review the data and impact of the proposal.

7. Indicated Shippers argues that the Commission's reliance on industry-wide price increases and Commission orders involving other pipelines does not support the proposal by Columbia Gulf. Indicated Shippers further argues that the approved penalties will lead to extremely conservative scheduling, thereby potentially foregoing opportunities to compete. Indicated Shippers contends that while Columbia Gulf relies on the potential for price arbitrage, it does not explain how this would or could occur or has occurred. Indicated Shippers further contends that the Commission's reliance on other orders contradicts the policies adopted in Order No. 637 by permitting penalty escalations which potentially limit shipper flexibility.[9] Indicated Shippers further asserts that the Commission mistakenly accepted Columbia Gulf's proposals to increase its non-OFO unauthorized overrun and failure to interrupt penalties. Indicated Shippers argues that the Commission made this determination by failing to note the distinctions between OFO and non-OFO penalties. Indicated Shippers further argues that the Commission should have considered the alternatives presented by other parties. Finally, Indicated Shippers contends that since Columbia Gulf's tariff permits it to net out the penalties revenues which it credits several categories of costs, Columbia Gulf may not be disinterested in penalty imposition.

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[8] *Citing* 18 C.F. R. §284.12(b)(2)(v)(2005).

[9] *Citing* Order No. 637 at 31,307-31,308.

Discussion

8. The Commission denies Indicated Shippers' request for rehearing of the November 23 Order. Indicated Shippers mistakenly argues that acceptance of Columbia Gulf's proposal was in conflict with the Commission's stated policy and regulations which limit penalties to the extent necessary to prevent the impairment of reliable service.

9. As the Commission explained in Order No. 637-A,[10] in denying requests to change the requirement that penalties be justified solely on the basis of system reliability:

> The pipelines themselves recognize that "the fundamental purpose of penalties and OFOs is to protect the reliability of service to all shippers…." [footnote omitted] It was precisely this purpose that the Commission recognized in Order No. 636, when it permitted pipelines to develop and utilize OFOs and penalties as system management tools. Thus, the requirement that pipelines impose penalties "only to the extent necessary to prevent the impairment of reliable service" *simply reflects a formalized requirement that pipelines use penalties exclusively for their intended purpose. The Commission is not permitting pipelines to impose penalties for other purposes, such as enforcement of contract obligations, where unrelated to system reliability.... The Commission reiterates that penalties may be required, especially during critical periods when system reliability is most in jeopardy*. [Emphasis added.]

Therefore, the limitation in the Commission's regulation was directed to limiting the intended purpose of the penalty to prevent the impairment of reliable service. However, the Commission expressly found that penalties may be imposed during critical periods.

10. With respect to the subject penalties contained in Columbia Gulf's tariff, the Commission has previously found, in the orders concerning Columbia Gulf's compliance with Order No. 637,[11] that these penalties are narrowly tailored to apply in situations where the shipper's conduct may impair reliable service. The Commission stated that:

> Columbia Gulf's existing penalty in section 19.2 against shippers that fail to interrupt service is acceptable since this penalty is limited to situations where the pipeline must interrupt services because of unforeseen

[10] *Regulation of Short-Term Natural Gas Transportation Services, and Regulation of Interstate Natural Gas Transportation Services*, Order No. 637-A, FERC Stats. & Regs. Preambles [1996-2000] ¶ 31,099 at 31,608-31,609 (2000)(Order No. 637-A).

[11] 100 FERC ¶ 61,344 and 104 FERC ¶ 61,035 (2003).

> conditions, announced system maintenance, or emergency situations which could threaten the operational performance of the pipeline. [[12]]

The Commission further stated that:

> Columbia Gulf's existing OFO penalty in section 19.3 is also reasonable since this penalty will only be assessed during critical periods when the integrity of the pipeline is threatened. [[13]]

11. The Commission found, in its order on rehearing of the order on compliance with Order No. 637, that Columbia Gulf had complied with its prior order by modifying section 19.1 to clearly state that the unauthorized overrun penalty will be waived if the unauthorized overrun does not cause an operational problem.[14]

12. In this proceeding, Columbia Gulf has only proposed to change the level of the penalties, not the conduct to which they apply. Indicated Shippers argues that, in approving Columbia Gulf's proposal, the Commission mistakenly relied on industry-wide price increase data and recently approved penalty increases. Indicated Shippers states[15] that the Commission relied on the following "findings:" (1) the increase in prices following the damage caused by Hurricanes Katrina and Rita; (2) the operational problems that could be created by that damage; and (3) Commission orders involving other pipelines that purportedly support the penalty increases. Indicated Shippers contends that none of these rationales supports Columbia Gulf's proposal. The Commission disagrees.

13. The Commission's primary concern with respect to penalties such as those at issue here, which only apply to conduct that is harmful to the system, is that the penalties be high enough to act as an effective deterrent to the harmful conduct. Since such conduct risks harm to other customers, as well as the pipeline, the Commission believes that significant penalties for such conduct are appropriate and consistent with Order No. 637. The Commission finds that Columbia Gulf has provided adequate support for its proposed penalty levels equal to three times the commodity price of gas.

[12] 100 FERC ¶ 61, 344 at P 112.

[13] 100 FERC ¶61,344 at P 113.

[14] 104 FERC ¶ 61,035 at P 50.

[15] Request for Rehearing at 14.

14. The Commission considered the increase in the price of gas to the Columbia Gulf's system and the potential for gas price increases in finding that Columbia Gulf could reasonably conclude that the existing penalty level was no longer adequate. Columbia Gulf stated in its transmittal letter in this proceeding, among other things, that:

> With commodity prices in the production area currently exceeding $10 per Dth, the existing $5.00 or $10.00 per Dth penalties currently reflected in Columbia Gulf's Tariff clearly will not deter the type of shipper conduct that could threaten system integrity and compromise Columbia Gulf's ability to meet firm service obligations. The potential for significant increases in natural gas prices during periods of the upcoming winter heating season, coupled with decreased supplies resulting from the hurricane damaged infrastructure, makes implementing penalties that exceed the price of natural gas absolutely imperative in order to provide appropriate incentives for shippers to comply with tariff-based protections that are in place to preserve system integrity. [[16]]

15. The Commission finds it reasonable that penalties for excess takes of gas be significantly in excess of the commodity price of gas during periods when the pipeline is unable to provide the full amount of service its customers desire due to operational constraints. If the penalty for taking excess gas from the pipeline is less than or in the same general range as the price of purchasing needed gas elsewhere, then an economically rational shipper would have an incentive to incur the penalty, rather than purchasing the gas elsewhere. Moreover, a shipper with a particular need for gas, for example to meet contractual obligations to its own customers, may have an incentive to take excess gas even when the penalty is somewhat higher than the current commodity cost of gas. For example, it may be important to a shipper in the business of buying and selling gas to maintain its reputation as a reliable supplier of gas. In such circumstances, a shipper could be willing to incur a fairly significant penalty in order to meet its own contractual obligation to its customers. Indeed, a captive customer of the pipeline may have no alternative means of obtaining gas.[17] For these reasons, the Commission has

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[16] October 25, 2005 Transmittal Letter at 1-2.

[17] Indicated Shippers argues that while Columbia Gulf relies on the potential for market advantage through price arbitrage, it does not explain how this would or could occur or if it has occurred. However, as explained above, the Commission's order is based on the need for penalties to be an effective deterrent to any shipper conduct that could impair reliable service, without regard to whether the reason a shipper takes the excess gas is for reasons of price arbitrage or the other reasons discussed above.

been willing to accept penalties for conduct that impairs operations that are a multiple of the commodity price of gas.[18]

16. Indicated Shippers contends that Columbia Gulf failed to support its proposed change in the level of its penalties, because it failed to present examples of shipper misconduct causing operational problems under the existing penalties. With increased gas prices and the potential for prices to continue rising, it is reasonable to conclude that Columbia Gulf's then-existing penalties might no longer act as an effective level to deterrent to actions that potentially threaten pipeline operations. The Commission finds it entirely appropriate for pipelines to anticipate problems and take action to forestall them, rather than waiting until such problems occur. Therefore, there is no need for Columbia Gulf to present an example of a shipper violation or general shipper behavior or operational stress on its system.

17. Indicated Shippers argues that increased penalties will result in extremely conservative scheduling, particularly in the context of capacity rights on Columbia Gulf's system, and potentially foregoing opportunities to compete. However, these penalties are specifically intended to discourage actions which would threaten reliable service. Shippers must be deterred from such conduct and may utilize other available tools required by Order No. 637, *i.e.*, imbalance management services, to avoid penalties and threats to reliable service. The goal of shipper flexibility does not include conduct which threatens system reliability and integrity. As the Commission stated in Order No. 637-A:

> The Commission has determined that shippers should be given the flexibility to exceed contractual limitations, unless such action jeopardizes system reliability and integrity. [[19]]

18. Columbia Gulf's penalties are consistent with this policy. For example, since Columbia Gulf's unauthorized overrun penalties are waived if the unauthorized overrun does not cause an operational problem, shippers may, consistent with Order No. 637, exceed their contractual limitations without incurring the unauthorized overrun penalty at

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[18] *Algonquin Gas Transmission, LLC,* 115 FERC ¶ 61,067 (2006) and the cases cited therein.

[19] Order No. 637-A at 31,608. In addition, Order No. 637-A (at 31,605) stated in its discussion of OFOs that "[T]he reliability of service to all customers should be of greater concern than the reduction in one shipper's flexibility, where system reliability is a genuine or legitimate concern." This principle is equally applicable in the context of penalties.

issue here if the unauthorized overrun does not cause operational problems. Similarly, the other penalties at issue here apply only when there is an operational need for them.

19. Indicated Shippers contends that the Commission's reliance on orders in other proceedings contradicts Order No. 637 by limiting shipper flexibility. Indicated Shippers asserts that the Commission has not explained why the approved penalties will not result in the escalation of penalties by other pipelines which the Commission sought to avoid in Order No. 637. However, the Commission has found the approved penalties to be just and reasonable in order to deter conduct which threatens system reliability on the Columbia Gulf system consistent with Order No. 637. Columbia Gulf does not allege the instant penalties are necessary in order to match the penalty levels of competing pipelines. Rather, the instant penalties are intended to minimize incentives to take excess gas that would exist regardless of the penalty levels on other pipelines. To the extent other pipelines are authorized to revise their penalties, such penalties must also be found to be consistent with the requirements of Order No. 637. In addition, as pointed out above, with respect to shipper flexibility, conduct which threatens system reliability or integrity is not consistent with the shipper flexibility which the Commission seeks to promote.[20]

20. Indicated Shippers argues that the Commission has failed to properly distinguish OFO penalties from failure to interrupt and unauthorized overrun penalties and has only relied on orders involving increases to OFO penalties. Indicated Shippers further argues that the Commission has accepted the non-OFO unauthorized overrun and failure to interrupt penalties and failed to recognize distinctions between Columbia Gulf's OFO and non-OFO provisions, asserting that even Columbia Gulf in its initial filing recognized the need to address different types of activity under the unauthorized overrun and failure to interrupt provisions. Indicated Shippers also contends that the Commission's finding that the unauthorized overrun penalty will be waived if the unauthorized overrun did not cause an operational problem appears to equate the unauthorized overrun penalty with an OFO. However, while the Commission, in the November 23 Order, did recognize the different circumstances under which the unauthorized overrun, failure to interrupt, and OFO penalties are imposed and OFO penalties, it also pointed out that it has consistently approved high penalties to deter conduct that might threaten pipeline operations.

[20] Indicated Shippers also argues that *Midwestern Gas Transmission Company*, 112 FERC ¶ 61,345 (2005) and *Viking Gas Transmission Company*, 112 FERC ¶ 61,098 (2005)) which it characterizes as the orders on which Columbia Gulf principally relied, were both un-protested letter orders which do not reflect Commission policy. However, these and other orders are consistent with the Commission policy to establish penalties at levels to prevent conduct that would impair system reliability established in Order No. 637.

21. As discussed above, the Commission has found, in the orders on compliance with Order No. 637, that the unauthorized overrun, failure to interrupt, and OFO penalties are all consistent with the limited purpose of preventing the impairment of reliable service required by Order No. 637. Columbia Gulf, in its transmittal letter, explained that the unauthorized overrun and failure to interrupt penalties apply across a broader set of operating circumstances than OFOs and may reduce the need to issue OFOs and that the shipper's actions may be before an OFO is issued or may be the root cause of the OFO.[21] Columbia Gulf further explained that the revision of these penalties is supported by the same reasons supporting modification of the OFO penalties, the need to ensure that all shippers have the proper incentive to comply with tariff provisions that preserve Columbia Gulf's system integrity.[22] Unauthorized overrun penalties are waived if the unauthorized overrun does not cause an operational problem, and failure to interrupt penalties apply when the pipeline must interrupt services when, because of force majeure, other unforeseen conditions, or operating conditions (such as, but not limited to, performing routine maintenance, making modifications, tests or repairs to Columbia Gulf's pipeline system or protection of the integrity and performance capability of its storage and transmission facilities), the gas available for delivery from Columbia Gulf's system or portion thereof is temporarily insufficient to meet all of its authorized firm services on any day. Similar to OFO penalties, the shipper conduct deterred by the unauthorized overrun and failure to interrupt penalties has a potential negative impact on system reliability and other shippers on the system and it is of critical importance that the level be sufficient to deter such conduct.

22. Indicated Shippers argues that the Commission should have considered other alternatives presented by parties.[23] However, the alternatives presented fail to support a finding that Columbia Gulf's proposed penalty level has not been shown to be a just and reasonable deterrent to the offending conduct. Indicated Shippers also contends that the Commission's reliance on orders approving similar penalties is misplaced because it has set no upper limit on penalties and that the Commission suggests that it has no choice but to accept Columbia Gulf's proposal. Concerning the level of these penalties, under the

[21] October 25, 2005 Transmittal Letter at 4.

[22] *Id*.

[23] Amerada Hess Corporation proposed that Columbia Gulf take the existing flat penalties of $5.00 and $10.00 per Dth, and have them serve as an adder to 100 percent of the index price. Process Gas Consumers Group proposed that the Commission direct Columbia Gulf to adopt either (i) penalties based on an index price plus twenty percent of that price, or (ii) penalties based on an index price plus a fixed additional amount, such as twenty dollars ($20) and asserted that, if commodity prices drop significantly, its proposed alternatives could, in fact, result in higher penalties than those approved.

statutory scheme set forth in the Natural Gas Act, the pipeline has the initiative through a section 4 filing to propose rates, terms, and conditions for the service it provides.[24] If the pipeline shows that its proposal is just and reasonable, the Commission must accept it, regardless of whether other rates, terms, or conditions might also be just and reasonable.[25] The level of penalties must be intended to prevent shipper behavior that could threaten the pipeline's operational integrity in the absence of such penalties. The shipper behavior which is deterred has a potential negative impact on the system and other shippers on the system and it is of critical importance that the level be sufficient to deter such conduct. The pipeline must have penalty provisions in place which are at a sufficient level to prevent impairment of reliable service. The level of the penalties necessary to deter the conduct is a matter of the exercise of reasonable judgment. The level of the penalties to deter impairment of reliable service approved in this case is similar to that proposed by other pipelines and approved by the Commission. Finally, the penalties charged to the offending shippers are credited to the non-offending shippers who were not responsible for the actions which threatened the system.

23. Indicated Shippers argues that Columbia Gulf may not be disinterested in penalty imposition since Columbia Gulf's tariff permits Columbia Gulf to exclude from its penalty revenues several categories of costs. Section 19.6 of Columbia Gulf's GT&C does allow it to exclude for penalty revenues credited "(A) Transporter's actual gas, transportation and retainage costs for the replenishment of gas quantities with respect to PAL Rate Schedule Section 5(b), and IMS Rate Schedule 5 (c), and (B) overrun charges imposed pursuant to the terms of any of Transporters Rate Schedules." These provisions are intended to ensure that Columbia Gulf is reimbursed for actual costs incurred with excess takes of gas. The fact that Columbia Gulf is permitted to recover such costs does not undercut our point that the requirement that it credit net revenues removes its incentive to increase penalty levels so as to use penalties as a profit center.

[24] *See United Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956).

[25] *See Western Resources, Inc. v. FERC*, 9 F.3d 1568 at 1578 (D.C. Cir. 1993).

24. The Commission concludes, based on the above discussion, that contrary to Indicated Shippers' argument, none of the further support requested by Indicated Shippers[26] or a technical conference is required.[27] Accordingly, rehearing is denied.

The Commission orders:

The request for rehearing of the November 23 Order in this proceeding is denied, as discussed in the body of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.

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[26] Indicated Shippers states the Commission has required pipelines to file some form of supporting information for proposed penalty increases such as, *i.e.*, a showing that penalties imposed by competing pipelines are at levels comparable with the proposed penalties, citing *Tennessee Gas Pipeline Company*, 99 FERC ¶ 61,017 at P 246 (2002)(*Tennessee*). However, in *Tennessee*, the Commission found that the pipeline could not propose an increase in fixed penalties in the context of a section 5 proceeding and that it was free to file a future section 4 proceeding.

[27] Indicated Shippers cites *Panhandle Eastern Pipe Line Company*, 78 FERC ¶ 61,202 (1997) and *Northern Natural Gas Company*, 76 FERC ¶ 61,108 at 61,555-61,556 (1996) where the Commission directed that technical conferences be convened. However, among other things, these proceedings were prior to the penalty requirements established and compliance determinations in the Order No. 637 proceedings.