

REPORT OF THE NATURAL GAS REGULATION COMMITTEE

On February 9, 2000, the Federal Energy Regulatory Commission (FERC or Commission) issued Order No. 637,¹ addressing “Regulation of Short-Term Natural Gas Transportation Services” (RM98-10) and “Regulation of Interstate Natural Gas Transportation Services” (RM98-12). The rule revised the Commission’s regulations to “improve the efficiency of the market and provide captive customers with the opportunity to reduce their cost of holding long-term pipeline capacity while continuing to protect against the exercise of market power.”² The new regulations required changes to pipelines’ tariffs to address scheduling equality, segmentation and flexible point rights, imbalance service, and operational flow orders.

The new regulations required pipelines to file tariff revisions in the summer of 2000. Those filings were followed by months of staff technical conferences and settlement discussions. This balance of this report focuses on the first implementation orders issued by the Commission under the new regulations, in *Colorado Interstate Gas Co.*, *Dominion Transmission Inc.*, and *Granite State Gas Transmission*.³

I. SCHEDULING EQUALITY

The Commission amended its regulations to provide that pipelines must give purchasers of released capacity the opportunity to submit a nomination at the first available opportunity after consummation of the purchase. It has stated that “the pipeline requires a replacement shipper to enter into a contract, that contract must be issued within one hour after the pipeline has been notified of the release.”⁴

A. Nominating Released Capacity

The Commission confirmed that new regulation 284.12(c)(1)(ii) requires replacement shippers to be able to nominate at the earliest available nomination opportunity after acquisition of capacity.⁵ This regulation is

1. Order No. 637, Final Rule, *Regulation of Short-Term Natural Gas Transportation Services and Regulation of Interstate Natural Gas Transportation Services*, III F.E.R.C. STATS. & REGS. ¶ 31,091 (2000); 65 Fed. Reg. 10,155 (2000), *order on reh’g*, [hereinafter *Order No. 637*]; Order No. 637-A, III F.E.R.C. STATS. & REGS. ¶ 31,099 (2000); *order denying reh’g*, Order No. 637-B, Final Rule, 92 F.E.R.C. ¶ 61,062 (2000), *appeal pending*, *Interstate Natural Gas Assn. of America v. FERC*, Nos. 98-1333, et al. (D.C. Cir. 2001).

2. *Id.* at 31,247.

3. *Colorado Interstate Gas Co.*, 95 F.E.R.C. ¶ 61,321 (2001), *order on reh’g*, 96 F.E.R.C. ¶ 61,186 (2001); *Dominion Transmission Inc.*, 95 F.E.R.C. ¶ 61,316 (2001), *order on reh’g*, 96 F.E.R.C. ¶ 61,270 (2001); and *Granite State Gas Transmission Inc.*, 95 F.E.R.C. ¶ 61,450 (2001), *order on reh’g*, 96 F.E.R.C. ¶ 61,273 (2001).

4. 18 C.F.R. § 284.12(c)(1)(ii) (2000).

5. 95 F.E.R.C. ¶ 61,321, at 62,112; 95 F.E.R.C. ¶ 61,316, at 62,079.

not limited only to prearranged transactions.⁶ The new regulation does not limit the ability to nominate at the next available opportunity after the award of the contract.⁷ Under the new regulation, “releasing shippers should be able to inform the pipeline of prearranged capacity release deals not subject to bid at any of the four nomination opportunities and the replacement shipper should be able to submit a nomination at the time the pipeline is informed of the release.”⁸ Several pipelines were required to amend their tariffs to conform to the new regulation.⁹

The Commission also approved a settlement that provided shippers releasing capacity to recall that capacity on a partial-day basis, stating that “permitting partial day recalls adds flexibility to the pipeline’s system and will enable shippers to coordinate recall rights with the intra-day nominations that shippers can currently submit.”¹⁰ For a partial day recall, the settlement calls for notification to the pipeline and the replacement customer by 3:00 pm, Eastern Time with nomination possible at 5:00 pm, Eastern Time and with gas flow at 9:00 pm, Eastern Time of the current gas day.¹¹

B. Contract Tendered

The Commission also confirmed that pipelines must add language to their tariffs to comply with the new requirement. Tariffs must state that “contracts for prearranged capacity release transactions not subject to bid will be tendered within one hour of the time the pipeline has been notified of the deal, and that contracts for biddable capacity release transactions will be tendered within one hour of the time the pipeline has awarded the capacity.”¹²

C. Volumetric Releases

The Commission confirmed that it did not change its policy of prohibiting replacement shippers paying a volumetric rate to re-release capacity because volumetric shippers do not pay a reservation charge to reserve capacity.¹³

II. SEGMENTATION AND FLEXIBLE POINT RIGHTS

The Commission required pipelines to permit shippers to segment their firm capacity into separate parts for a shipper’s own use or for the purpose of releasing that capacity to replacement shippers, to the extent

6. *Id.*; 95 F.E.R.C. ¶ 61,316, at 62,079.

7. 95 F.E.R.C. ¶ 61, 321, at 62,112; 95 F.E.R.C. ¶ 61,316, at 62,079.

8. *Id.*; 95 F.E.R.C. ¶ 61,316, at 62,079.

9. *Colorado Interstate Gas Co.*, 95 F.E.R.C. ¶ 61,321, at 62,112 (2001); 95 F.E.R.C. ¶ 61,450, at 62,632.

10. *Dominion Transmission Inc.*, 95 F.E.R.C. ¶ 61,316, at 62,082 (2001).

11. *Id.* at 62,080.

12. 95 F.E.R.C. ¶ 61,321, at 62,112; 95 F.E.R.C. ¶ 61,450, at 62,532.

13. *Id.*

the segmentation is operationally feasible.¹⁴

A. Segmentation

The Commission found reasonable a segmentation proposal that allows shippers to divide their capacity into discrete segments using receipt and delivery points that differ from the primary points in the service agreement based on five operational prerequisites: (1) the segmented transaction's receipt or delivery point must be within the primary flow path (dubbed the "one-foot-in-bounds" rule); (2) the segmented capacity cannot exceed the original primary capacity; (3) segmentation requests for flow in the opposite flow direction from the original primary path are incremental to other segmentation activity on the same segment when considering the primary capacity limitation; (4) segmentation is subject to availability of capacity and contractual obligations at and between the new points of receipt and delivery; and (5) the thermal content of the gas received or delivered at the segmented points cannot be less than the thermal content of gas at the original point(s) of receipt or delivery under the shipper's service agreement.¹⁵ The Commission also approved, subject to one year review, the pipeline's reservation of the "right to control or restrict any segmented transaction on its system if the transaction would degrade [the pipeline's] existing service, or pose a threat to the sound operation of the system."¹⁶

Twenty-day prior notice of segmentation was permitted for reticulated systems, subject to the caveat that the pipeline should endeavor to conduct the review as quickly as possible, report on the prior request procedure after one year of experience, and should include evaluation factors in its tariff.¹⁷ The required evaluation factors are: (1) the impact of the requested transaction on the overall thermal content of gas on the reticulated system; (2) the impact on the direction of flow across various segments of the reticulated system; (3) the availability of capacity at new receipt or delivery points that the shipper uses as a result of segmentation; (4) the impact on displacement capacity; and (5) the impact on the pipeline's storage field operations.¹⁸ Finally, the Commission approved suspension of segmentation on one pipeline's reticulated system, subject to one year review if there "is a system operational upset requiring an operational flow order (OFO) affecting the segmented transaction," or if changed capacity "demands on the system would impair the ability to continue the segmented transaction."¹⁹

The Commission also approved a settlement that provided for segmentation of market center points on a portion of a reticulated system as

14. 18 C.F.R. § 284.7(d) (2000).

15. 95 F.E.R.C. ¶ 61,321, at 62,113-14.

16. *Id.* at 62,114, 62,116.

17. *Colorado Interstate Gas Co.*, 95 F.E.R.C. ¶ 61,321, at 62,116 (2001).

18. *Id.* at 62,114.

19. 95 F.E.R.C. ¶ 61,321, at 62,117.

part of a settlement between customers who demanded full segmentation rights and local distribution companies that were concerned that physical segmentation would degrade their service.²⁰ In approving the settlement, the Commission reaffirmed its Order No. 637 ruling that pipelines must “optimize [their] system to provide maximum segmentation rights while devising appropriate mechanisms to ensure operational stability.”²¹

The Commission rejected a proposal that “would only permit a shipper to segment its capacity for its own use on a secondary firm or interruptible basis” and not a primary basis.²² It also rejected as ambiguous, tariff language that stated a “Releasing Customer may segment its capacity on Transporter’s pipeline to the extent segmentation is operationally feasible” and that required the pipeline to clarify the rights of replacement shippers with regard to segmentation on a primary point basis.²³

B. Mainline Priority at Secondary Points

Order No. 637-A provided “that each pipeline must afford a higher priority over mainline capacity to shippers seeking to use a secondary point within their capacity path than to shippers seeking to use mainline capacity outside of their path, unless the pipeline can demonstrate” the unfeasibility of doing so for operational reasons.²⁴

The Commission approved a proposal that allows a segmenting shipper to nominate up to its maximum daily quantity in any number of combinations of receipt and delivery points, as long as at least one point in the transaction is within the primary flow path (the one-foot-in-bounds-rule). The Commission also held that “[s]egmentation transactions that are entirely outside the primary flow path would be scheduled on a secondary basis.”²⁵

The FERC also approved a settlement that did not address the allocation of primary point rights in segmented releases and within-the-path scheduling because of the reticulated nature of the pipeline system.²⁶

Where a pipeline did not address this issue in its compliance filing, the Commission required the pipeline to either file the revisions or demonstrate the operational unfeasibility of the proposal.²⁷

C. Segmentation of Capacity Reserved on Other Systems

The Commission rejected a proposal from a pipeline that reserves ca-

20. 95 F.E.R.C. ¶ 61,316, at 62,083.

21. *Id.*

22. 95 F.E.R.C. ¶ 61,450, at 62,633.

23. *Id.*

24. 95 F.E.R.C. ¶ 61,321, at 62,117.

25. *Id.* at 62,117-18.

26. 95 F.E.R.C. ¶ 61,316, at 62,083.

27. *Granite State Gas Transmission Inc.*, 95 F.E.R.C. ¶ 61,450, at 62,634 (2001).

capacity on another system to prohibit its shippers from segmenting that capacity.²⁸

D. Discounts at Segmented or Secondary Points

In Order No. 637-A, the Commission stated that the interaction of its segmentation policy and its current policy of permitting shippers to limit discounts to particular points would require reexamination in the compliance filings. Subsequently, in its orders on compliance filings, the Commission created a rebuttable presumption that if there are discounted contracts to a point, then any shipper moving gas to that point is entitled to that same discount, unless the pipeline can show why competitive circumstances dictate otherwise. In other words, if a shipper was segmenting or releasing to a point on a secondary basis, and others had discounts at that point, then the shipper will likely be entitled to that discount as well. Prior to this policy change, if a shipper had a discounted contract that was then segmented or released to a point on a secondary basis, the discount no longer applied and the contract became a maximum rate contract with the pipeline.²⁹ The Commission adhered to this same rebuttable presumption policy pronouncement in subsequent compliance orders.³⁰

III. IMBALANCE SERVICES

Order No. 637 requires “pipelines with imbalance penalty provisions in their tariffs to provide, to the extent operationally practicable, imbalance management services, such as park and loan service.”³¹ Pipelines may not give undue preference to their own balancing services over third-party services.

The Commission found a pipeline to be in compliance with Order No. 637 because it offered shippers adequate flexibility in managing imbalances on its system by: (1) providing timely information as to imbalance status through posting of daily and cumulative imbalances on the day after gas flow; (2) offering services to enable shippers to avoid imbalance within the month, including no-notice, swing, firm and interruptible contract storage, and park and lending services; and (3) offering imbalance management tools for shippers to resolve imbalances after the month in which the imbalance occurred, by netting all imbalances across contracts and trading imbalances through the last day of the month following the month in which the imbalance occurred.³² Likewise, the Commission approved a settlement that provides for imbalance netting and trading services, and alternative methods of curing imbalances through the use of an “in-kind” cure period and imbalance trading, in addition to its existing no-notice,

28. *Colorado Interstate Gas Co.*, 95 F.E.R.C. ¶ 61,321, at 62,119 (2001).

29. 95 F.E.R.C. ¶ 61,321, at 62,121.

30. 95 F.E.R.C. ¶ 61,450, at 62,635.

31. *Dominion Transmission Inc.*, 95 F.E.R.C. ¶ 61,316, at 62,084 (2001).

32. 95 F.E.R.C. ¶ 61,321, at 62,122.

interruptible, and parking and loaning services.³³

Where a pipeline's tariff did not impose its own imbalance penalties, the pipeline was not required to add imbalance services.³⁴

A. *Imbalance Cash-out and Unauthorized Overrun Penalties*

Order No. 637 provided that a pipeline's penalty structure adhere to three principles:

1. Penalties can be included in the tariff only to the extent necessary to prevent the impairment of reliable service.
2. A pipeline must credit to shippers all revenues from all penalties net of costs.
3. A pipeline must provide to shippers, on a timely basis, as much information as possible about the imbalance and overrun status of each shipper and the imbalance of the pipeline's system as a whole.

Because of services offered by a pipeline to avoid overruns and otherwise manage imbalances, the Commission approved as reasonable the continuation of a "tiered cash out mechanism" that imposes penalties for imbalances.³⁵ The Commission reiterated that a pipeline's penalty structure and level should relate to the harm the imbalance is likely cause to the pipeline's system. Accordingly, the Commission found that a pipeline's penalties for unauthorized overruns were too high at times other than critical periods when the system is constrained. Higher penalties on a seasonal basis (October – April) were not permitted.³⁶ The pipeline was required to revise its tariff so that the unauthorized overrun penalties would be applicable only during critical periods. For non-critical periods, the Commission recommended a penalty that is "sufficient to provide an incentive to nominate overrun volumes but that also takes into account the lessened impact such unauthorized overruns will have on the system during non-critical times."³⁷

The Commission approved a settlement as consistent with the penalty principles enunciated in Order No. 637, where the settlement provided for overrun penalties only when an OFO is issued or for violations of the OFO and provided for crediting of the revenue from penalties, net of costs, to non-offending shippers.³⁸ Unauthorized overrun charges that will apply "when a customer takes service in excess of its contract entitlement when

33. 95 F.E.R.C. ¶ 61,316, at 62,085.

34. 95 F.E.R.C. ¶ 61,450, at 62,635.

35. 95 F.E.R.C. ¶ 61,321, at 62,124.

36. *Id.* at 62,124-25.

37. *Colorado Interstate Gas Co.*, 95 F.E.R.C. ¶ 61,321, at 62,125 (2001).

38. 95 F.E.R.C. ¶ 61,316, at 62,087.

not authorized by [the pipeline] and when a penalty does not apply”³⁹ (in a non-OFO situation) were also approved as part of an overall settlement, even though the Commission stated that the pipeline had simply renamed a penalty as a service.⁴⁰

IV. OPERATIONAL FLOW ORDERS

Order No. 637 required pipelines to take all reasonable actions to minimize the issuance and adverse impacts of OFO’s or other measures taken to respond to adverse operational events on its system. Specifically, the Commission required pipelines to include in their tariffs:

[1] . . . clear, individualized standards, based on objective operational conditions, for when OFO’s begin and end; . . . [2] information about the status of operational variables that determine when an OFO will begin and end; . . . [3] . . . the steps and order of operational remedies that will be followed before an OFO is issued; . . . [4] . . . standards for different levels or degrees of severity of OFO’s to correspond to different degrees of system emergencies the pipeline may confront; and . . . [5] . . . reporting requirements that provide information after OFO’s are issued on the factors that caused the OFO to be issued and then lifted. . . .⁴¹

The Commission found reasonable a pipeline’s proposal to revise its tariff provisions on OFO’s to provide greater detail regarding the types of operational functions that can be supported by an OFO, including:

(1) blending gas supplies to meet minimum gas quality specifications at points of delivery; (2) adjusting line pack to meet minimum pressure obligations at points of delivery; (3) adjusting storage inventory to comply with transporter’s Reservoir Integrity Inventory Limit; and (4) adjusting points of receipt and delivery quantities to realize compressor and processing plant minimums.⁴²

The Commission underscored its requirement that a pipeline minimize the use and adverse impacts of OFO’s. The Commission found that tariff provisions are consistent with this requirement in the tariff:

- providing for shippers to be informed “of operational information such as scheduled maintenance and storage guideline for the upcoming month. . .”⁴³
- requesting that shippers adjust nominations before an OFO is issued
- “limit[ing] the scope of an OFO to those shippers causing the

39. *Id.* at 62,085.

40. 95 F.E.R.C. ¶ 61,316, at 62,088.

41. *Order No. 637*, *supra* note 1, at 31,312-14.

42. 95 F.E.R.C. ¶ 61,321, at 62,126.

43. *Id.* at 62,126.

- problem that necessitates the issuance the OFO. . .”⁴⁴
- specifying “the conditions underlying [the OFO] and describ[ing] the specific response required from the affected parties. . .”⁴⁵
 - Providing shippers with “updated information concerning the status of operational variables related to the OFO as soon as it is available. . .”⁴⁶
 - Requiring the pipeline to take actions to correct operational problems before an OFO is issued.⁴⁷

NATURAL GAS REGULATION COMMITTEE

Jane Lewis, Chair

Donald K. Dankner, Vice Chair

Allan W. Anderson, Jr.	J. Michel Marcoux
Frederic G. Berner	Timothy E. McKee
Deborah A. Carpentier	James D. McKinney, Jr.
Cristopher J. Catillo	Erin J. McTaggart
Michael C. Dotten	Kenneth R. Meade
Katherine B. Edwards	David J. Muchow
James G. Flaherty	John H. Norris
Robert S. Fleishman	Richard A. Oliver
Michael J. Fremuth	Shemin V. Proctor
Jeffrey L. Futter	Randall S. Rich
Mark R. Haskell	John R. Schaeffgen, Jr.
Sheila S. Hollis	Louis G. Shott
David L. Huard	Marisa A. Sifontes
James P. Johnson	Carol A. Smoots
Judy M. Johnson	Regina Y. Speed-Bost
Bradford G. Keithley	J. Berry St. John, Jr.
Georald L. Knowles	Roderick D. Strickland
Stefan M. Krantz	Kevin M. Sweeney
Kurt L. Krieger	Michael J. Thompson
Gregory K. Lawrence	Jay T. Waldron
Mark Kevin Lewis	Rex H. White

44. 95 F.E.R.C. ¶ 61,321, at 62,126.

45. *Id.*

46. 95 F.E.R.C. ¶ 61,321, at 62,126.

47. *Id.* at 62,126-27.

WHERE CAN YOU GET BACK
VOLUMES AND ISSUES?

ORDER THROUGH HEIN!



We have obtained the entire back stock, and
have rights to reprint and microform the:

ENERGY LAW JOURNAL

Complete sets to date are now available.
We can also furnish single volumes and issues.

WILLIAM S. HEIN & CO., INC.

1285 Main Street

Buffalo, New York 14209

TOLL FREE (800)828-7571 • (716)882-2600 • TeleFax (716)883-8100

