UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Bay Gas Storage Company, Ltd. Docket No. PR04-9-004

ORDER DENYING REHEARING

(Issued September 1, 2006)

1. On May 12, 2006, Bay Gas Storage Company, Ltd. (Bay Gas) requested clarification or, in the alternative, rehearing of the Commission's April 14, 2006 Order.[1] Bay Gas contends that the Commission erred in making rate impact comparisons with respect to Bay Gas's proposed roll-in of its Whistler spur facilities because the Commission failed to correctly consider the impact of the discount adjustment on the rate levels.

I. Background

2. Bay Gas began operations of its original facilities in 1994.[2] The original facilities include a 22-mile pipeline that runs due south from Bay Gas's storage facilities at McIntosh, Alabama, to its Salco Station, located north of Mobile, at Axis, Alabama. They interconnect with Gulf South Pipeline Company, L.P. (Gulf South) and Mobile Gas Service Corporation (Mobile Gas) at Salco Station. In 2002, Bay Gas constructed the Whistler spur facilities, which generally run southwest from Salco Station 17.5 miles to Whistler Junction, where there is another interconnection with Gulf South and Mobile Gas.

3. Before this rate case, Bay Gas maintained separate transportation rates for service on each set of pipeline facilities in addition to market-based storage rates for service on

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[1] *Bay Gas Storage Co., Ltd.*, 115 FERC ¶ 61,049 (2006) (April 14, 2006 Order).

[2] *Bay Gas Storage Co., Ltd.*, 66 FERC ¶ 61,354 (1994) (approving market-based storage rates for original facilities).

Bay Gas's storage facilities.[3] In this proceeding, Bay Gas proposed rolled-in rates for firm and interruptible transportation services on the combined pipeline facilities, under section 311 of the Natural Gas Policy Act of 1978 (NGPA).[4]

4. On November 8, 2005,[5] the Commission rejected Bay Gas's rolled-in rate proposal. The Commission applied its current policy concerning rolled-in versus incremental rates on interstate pipelines, as set forth in our 1999 Pricing Policy Statement.[6] Under that policy, the Commission requires that existing shippers not be required to subsidize the expansion shippers. Therefore, the Commission generally rejects rolled-in rate proposals, if rolling in the costs of an expansion would increase the rates of the existing shippers. In this case, the Commission concluded that the rolled-in maximum rates for Bay Gas's section 311 transportation service would be $2.7120 per MMBtu for firm transportation-only service, and $0.0892 per MMBtu for interruptible transportation-only service. These rolled-in rates were higher than non-rolled-in maximum rates for service on the non-Whistler spur facilities, which are $1.5991 per MMBtu for firm transportation service, and $0.0526 per MMBtu for interruptible transportation service.[7] Moreover, the Commission found that Bay Gas had not shown a specific benefit from the expansion to justify the increased rolled-in rate vis-à-vis the Commission's no-subsidy policy.[8]

5. Bay Gas requested clarification or rehearing of the November 8, 2005 Order, contending that the Commission's determination that rolling in the Whistler spur facilities would cause an increase in the maximum rates for service on the non-Whistler spur facilities was based on an incorrect comparison. Bay Gas argued that the rate impact of a roll-in must be determined independently of a discount adjustment. Bay Gas maintained that the appropriate methodology for determining rate impact is to compare rolled-in maximum rates, independent of the discount adjustment, with non-rolled-in maximum rates for non-Whistler spur facilities service. Bay Gas also reiterated that there are sufficient benefits to justify a roll-in.

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[3] *Bay Gas Storage Co., Ltd.*, 97 FERC ¶ 61,020 (2001) (approving rates for Whistler spur pipeline facilities); 99 FERC ¶ 61,263 (2002) (approving rates for non-Whistler spur pipeline facilities).

[4] 15 U.S.C. § 3371 (2000).

[5] *Bay Gas Storage Co., Ltd.*, 113 FERC ¶ 61,140 (November 8, 2005 Order).

[6] *Certification of New Interstate Natural Gas Pipeline Facilities*, 88 FERC ¶ 61,227 (1999), *clarifying*, 90 FERC ¶ 61,128 (2000), *order on reh'g*, 92 FERC ¶ 61,094 (2000) (1999 Pricing Policy Statement).

[7] November 8, 2005 Order, 113 FERC ¶ 61,140 at P 21.

[8] *Id.* P 22.

6. On April 14, 2006, the Commission denied Bay Gas's request for rehearing. The Commission reaffirmed its prior holdings that rolling in the costs of the Whistler spur facilities would increase the maximum rate applicable to service on the non-Whistler facilities and that the Whistler spur facilities do not provide sufficient benefits to justify roll-in. The Commission explained that Bay Gas's assertion that, if the discount adjustment is excluded from the analysis, a roll-in would decrease the maximum rate for service on the non-Whistler spur facilities is based on an incorrect comparison. Bay Gas compared a rolled-in rate of $1.3298 per MMBtu determined without a discount adjustment, to a non-rolled-in rate for the non-Whistler spur facilities of $1.5990 per MMBtu determined with a discount adjustment. The Commission held that this was an improper an apples-to-oranges comparison.

7. The Commission stated that, since Bay Gas has proposed to design its rates in this proceeding using billing determinants that are adjusted to reflect discounts, the rates approved in this proceeding will reflect a discount adjustment whether or not the Commission approves the rolled-in rate proposal. Therefore, in determining whether rolling in the costs of the Whistler Spur would increase the maximum rates for service on the non-Whistler spur facilities, it was appropriate to include a discount adjustment in the calculation of those rates both with and without a roll-in. The Commission further stated that, if the rate impact determination were to be made excluding a discount adjustment, then consistency would require excluding the discount adjustment from the calculation of both the rolled-in rates and the non-rolled-in rates. Excluding the discount adjustment in this manner would result in a rolled-in rate of $1.3298 for service on the non-Whistler spur facilities and a non-rolled-in rate for service on these facilities of $0.8366.[9] Thus, even excluding the discount adjustment from the analysis, there would be a rate increase of $0.4932 per MMBtu. The Commission concluded that, under either scenario, whether the discount adjustment is included or excluded from the comparison of maximum rates for service on the non-Whistler spur facilities with and without a roll-in, a rate increase results from rolling the costs of the Whistler Spur, thereby requiring shippers on the non-Whistler spur facilities to subsidize the Whistler spur expansion shippers.

8. With respect to the alleged benefits, the Commission reiterated that Bay Gas did not show that its proposed rolled-in rates would provide specific benefits to non-Whistler spur system shippers. The Commission found that Bay Gas's contention that roll-in will reduce regulatory expenses by $30,000 to be a negligible benefit, and in any event Bay Gas had not supported its contention that there would be any increase in regulatory expenses. The Commission also repeated its finding in the November 8, 2005 Order that

[9] The non-rolled-in rate for the non-Whistler spur facilities (excluding discount adjustment) of $0.8366 is calculated by dividing the total system cost of service of the original facilities ($2,609,342) by the total billing units for the non-Whistler spur facilities (3,118,800).

access to additional gas supplies and flexibility "cannot be considered a benefit for those shippers in light of the fact that Bay Gas has stated it will not permit those shippers to use the Whistler spur facilities under their existing contracts."[10]

II. Request for Rehearing

9. In its May 12, 2006 request for clarification or rehearing, Bay Gas maintains that the Commission erred in making rate impact comparisons without properly considering the effect of discounting on the proposed rolled-in rates. Although Bay Gas does not dispute the previously calculated rolled-in and non-rolled-in rates, reflecting a discount adjustment as well as reflecting no discount adjustment,[11] Bay Gas avers that the rate increase for the existing shippers is caused by the discount adjustment, not roll-in.[12]

10. Bay Gas admits that a rolled-in rate with a discount adjustment would be $2.7120, which is substantially higher than the existing non-Whistler spur shippers' non-rolled-in rate with a discount adjustment of $1.5990. However, Bay Gas points out that, if there were no discount adjustment, the existing shippers' rolled-in rate would be only $1.3298. It therefore asserts that discount adjustment is responsible for increasing the existing shippers' rolled-in rate from $1.3298 to $ 2.7120. Bay Gas contends that, since the existing non-Whistler spur shippers' discount adjusted rate ($1.5990), without a roll-in, is above $1.3298 but below $2.7120, the entire rate increase for the existing shippers resulting from a roll-in should be attributed to the discount adjustment and not the roll-in. It argues that "[d]iscounting, not roll-in drives all of the rate increase above … the $1.5990 rate … all the way up to the $2.7120 discount/roll-in rate level sought here."[13] Accordingly, Bay Gas concludes that, because "discounting masks the fair and equitable rate impact analysis," the correct comparison (of non-rolled-in and rolled-in rates) is

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[10] November 8, 2005 Order, 113 FERC ¶ 61,140 at P 23.

[11] Bay Gas lists the rates as follows:

Discount/roll-in	$2.7120
Discount/no roll-in	$1.5990
No discount/roll-in	$1.3298
No discount/no roll-in	$0.8366

We note that Bay Gas uses "discount" as shorthand for "reflecting discount adjustment."

[12] May 12, 2006 Request for Rehearing at 3.

[13] *Id.* at 4; *see also Id.* ("The *rate increase* therefore is due to discounting, not roll-in.") (emphasis added).

between the $1.5990 non-rolled-in rate, which reflects a discount adjustment, and "the rate range from the $1.3298 no discount/roll-in level up to the $2.7120 discount/roll-in level."[14]

11. Bay Gas also maintains that there are sufficient benefits to all non-Whistler spur shippers to justify roll-in. While Bay Gas concedes that non-Whistler spur shippers are not entitled to access the Whistler spur facilities, they argue that roll-in is beneficial because they would have an option of accessing the entire system on a newly negotiated basis. Moreover, Bay Gas maintains that the Whistler Spur facilities provide other benefits to shippers, which include increased access to reliable storage service infrastructure, system reliability, and flexibility.

III. Discussion

12. The Commission denies Bay Gas's request for rehearing. The Commission reaffirms its prior holdings that rolling in the costs of the Whistler spur facilities would increase the maximum rate applicable to service on the non-Whistler spur facilities, and that the Whistler spur facilities do not provide sufficient benefits to shippers on the non-Whistler spur system to justify imposing on them the rate increase caused by the roll-in.

13. In determining whether rolling in the costs of an expansion will increase the maximum rate for service on the pre-expansion system, the Commission compares the maximum rate for service on the pre-expansion system calculated without any roll-in with the maximum rate for service on the pre-expansion system calculated with a roll-in of the expansion costs. There are, of course, many variables that go into calculating a rate. These include (1) each item in the pipeline's cost-of-service and (2) the contract demand billing determinants and throughput used in designing the rate, including any adjustment for discounting. In order to isolate the rate impact of the roll-in, all these variables must be held constant, with the exception of including the costs of the expansion and the rate design volumes associated the expansion in the calculation of the rolled-in rate, while excluding them from the calculation of the non-rolled-in rate. It is undisputed that when calculated in this manner, a roll-in of the Whistler spur facilities costs increases the maximum rate for service on Bay Gas's non-Whistler spur facilities from $1.5990 to $2.7120, using discount-adjusted rate design volumes. Bay Gas seeks to attribute this increase to the discount adjustment, pointing out that, if a rolled-in rate were calculated without a discount adjustment, the rolled-in rate would be only $1.3298, or somewhat less than the $1.5990 no roll-in rate determined with a discount adjustment. However, Bay Gas did in fact enter into discounted rate agreements with various shippers on its non-Whistler spur facilities before this rate case. Regardless of the roll-in of the costs of the Whistler spur facilities, Commission policy permits Bay Gas to reduce the

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[14] *Id.* at 3-4.

volumes it uses to design its maximum rates for service on the non-Whistler spur facilities to reflect these discounts. Thus, the discount adjustment will increase the maximum rates for service on the non-Whistler spur facilities whether or not the Commission approves a roll-in of the Whistler spur facilities costs. In fact, without a discount adjustment, the no roll-in maximum rate for service on the non-Whistler spur facilities would be only $0.8366, as opposed to the actual no roll-in maximum rate with a discount adjustment of $1.5990.

14. Since the discount adjustment would exist regardless of whether the Whistler spur facilities costs are rolled-in, the Commission finds that the rate impact of the roll-in should be determined by comparing the maximum non-rolled-in rate for the non-Whistler spur facilities designed with discounted-adjusted rate design volumes, with a rolled-in rate also designed with discount-adjusted rate design volumes. Bay Gas suggests that this is somehow improper, because "comparing greater levels of roll-in costs . . .with lesser levels of no-roll-in costs," while using discount adjusted rate design volumes to calculate both rolled-in rates and non-rolled-in rates, "meant only that the latter, lesser, no roll-in costs resulted in lower rates. . . . Roll-in costs were greater, making roll-in rates always higher, by definition."[15] But that is just our point. If rolling in the higher costs of an expansion, along with using any additional rate design volumes resulting from the expansion, increases the per unit maximum rate for service on the pre-expansion system, that rate increase is caused by the roll-in and would require service on the pre-expansion system to subsidize service on the expansion system.

15. This conclusion is not altered by the fact discounted rate transactions on the pre-expansion reduce the rate design volumes associated with service on the pre-expansion system. As the Commission pointed out in the April 14, 2006 Order, if all existing volumes on Bay Gas flowed at the maximum rate so that there was no discount adjustment, then the maximum rate for service on Bay Gas's pre-expansion system without a roll-in would be $0.8366, and rolling in the Whistler spur facilities costs would increase that rate to $1.3298. In that circumstance, the rate increase would unquestionably be the result of the roll-in, as opposed to any discount adjustment. The fact Bay Gas has provided discounts for service on the non-Whistler spur facilities should not change this finding. Because of the reduction in rate design volumes arising from those discounts, the actual maximum rate without roll-in for service on the non-Whistler spur facilities is $1.5990, rather than $0.8366. The Commission sees no reason why the existence of that discount adjustment should justify treating the further increase in the maximum rate to $2.7120 due to the roll-in as being attributable to the discount adjustment, rather than the roll-in.

16. Bay Gas again points out that, because all existing shippers on the non-Whistler spur system currently have fixed, discounted rates, adopting a single rolled-in maximum

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[15] Bay Gas Request for Rehearing at 5-6.

rate for service throughout Bay Gas's system cannot increase the rates paid by the existing shippers until the end of their current contracts, and thus there cannot be any rate subsidy until the end of the current contracts. However, if the Commission accepted Bay Gas's rolled-in rate proposal, Bay Gas would be able to demand that the existing shippers pay the rolled-in rate after their current contracts expired, even if an existing shipper on the non-Whistler spur facilities only wanted to continue its existing service on the non-Whistler spur facilities. The April 2006 Order states, however, that under the 1999 Pricing Policy Statement a pre-expansion shipper with an expiring contract can only be required to pay a higher rate reflecting expansion costs when certain preconditions are met. These include that the conditions that the pipeline is full and there is a competing bid higher than the pre-expansion rate so that the higher rate is needed to allocate available capacity. Accepting Bay Gas's instant rolled-in rate proposal, however, would permit Bay Gas to demand that the shippers on the non-Whistler spur system pay the higher rolled-in rate when their current contracts expire regardless of whether these preconditions are met.

17. The Commission has stated that maximum rates for service on pre-expansion facilities can be increased for projects that improve the pre-expansion service and that, where a project combines an expansion with improvements to existing services, a pipeline can file to increase existing rates when the pipeline can demonstrate that the new facilities are needed to improve service to existing customers. The Commission also has stated that the no-subsidy policy recognizes that existing customers should pay the costs of projects designed to improve their service by replacing existing capacity, improving reliability, or providing additional flexibility.[16] However, there must be a specific benefit from the project for the pre-expansion service rather than generalized benefits resulting from the project being integrated into the system.[17]

18. Here, as we have previously explained, the Whistler spur facilities do not provide such benefits to shippers on the non-Whistler spur system, since Bay Gas does not give its shippers flexible point rights. Thus, a shipper which contracts for service only on the non-Whistler spur facilities has no access to the Whistler spur facilities. Bay Gas suggests that when the non-Whistler spur shippers' current contracts expire, they could modify those contracts to include service on the Whistler spur facilities. However, Bay Gas's rolled-in rate proposal would enable it to charge the rolled-in rate to the non-Whistler spur shippers even if they do not choose to so modify their current contracts. We accordingly continue to find that Bay Gas has not shown any real improvement in the pre-expansion service or other specific benefit to the original shippers to justify accepting its rolled-in rate proposal.

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[16] *El Paso Elec. Co.*, 108 FERC ¶ 61,071, at P 30-35 (2004) (averaging "range of profits" in order to calculate refund).

[17] *Transcontinental Gas Pipe Line Corp.*, 106 FERC ¶ 61,299, at P 75 (2004).

19. Accordingly, we continue to find that incremental rate treatment of the Whistler spur (expansion) facilities is appropriate, and therefore deny Bay Gas's request for rehearing.

The Commission orders:

Bay Gas's request for rehearing is hereby denied, as discussed in the body of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.