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.

Florida Gas Transmission Company — Docket No. CP06-1-001

ORDER DENYING REQUEST FOR REHEARING

(Issued November 29, 2006)

1. On June 15, 2006, in Docket No. CP06-1-000, the Commission issued Florida Gas Transmission Company (FGT) certificate authorization under section 7 of the Natural Gas Act (NGA) to construct and operate its proposed Phase VII Expansion Project, consisting of 32.6 miles of 36-inch diameter pipe and 9,800 hp of compression, to enable FGT to provide firm summer transportation for an additional 160,000 MMBtu/d of gas.[1] The June 2006 Order denied FGT's request for a predetermination favoring including the proposed expansion's costs in the rates for service under Rate Schedule FTS-2 in a future NGA section 4 rate proceeding. On June 17, 2006, FGT filed for rehearing on this matter. For the reasons discussed below, the Commission affirms its decision not to provide a predetermination favoring rolled-in rate treatment for the Phase VII Expansion Project and denies FGT's request for rehearing.

Background

2. FGT owns and operates an interstate pipeline system that extends along the arch of the coast of the Gulf of Mexico through the states of Texas, Louisiana, Mississippi, Alabama, and Florida. Under Rate Schedule FTS-2, FGT offers firm transportation

[1] *Southern Natural Gas Company (Southern)*, 115 FERC ¶ 61,328 (2006). In the June 2006 Order, in addition to authorizing FGT's proposed Phase VII Expansion Project, the Commission issued certificate authorization to Southern in Docket No. CP05-388-000 to construct and operate its Cypress Pipeline Project – a 177-mile long project intended to transport up to 500 MMcf/d of regasified liquefied natural gas (LNG) from an interconnection with the Elba Island LNG import terminal near Savannah, Georgia, to an interconnection with FGT. No party sought rehearing regarding Southern's Cypress Pipeline Project.

service on its Incremental System, which consists of mainline expansions placed into service starting with FGT's Phase III Expansion Project in 1993.

3. As described in the June 2006 Order and FGT's application, service on the Phase VII Expansion Project will be phased in over the first three years of its operation. Beginning May 1, 2007, FGT will transport up to 60,000 MMBtu/d for Progress Energy Florida, Inc. (Progress Energy). Beginning May 1, 2008, Progress Energy's service will increase to a maximum daily quantity of 80,000 MMBtu/d. Beginning May 1, 2009, FGT will transport up to 100,000 MMBtu/d for Progress Energy, plus up to 60,000 MMBtu/d for BG LNG, Inc. (BG). The Phase VII Expansion Project's annual revenues are not projected to exceed the project's annual costs until Year 4 of operation. FGT anticipates annual revenue shortfalls of $5,152,419 in Year 1, $2,300,328 in Year 2, and $260,183 in Year 3. FGT anticipates the project's aggregate deficit will be eliminated by the end of Year 7.

4. In its application, FGT stated that agreements for firm transportation service with Progress Energy and BG would generate revenues of $163.4 million over the first ten years of service, exceeding the estimated cost-of-service of $154.4 million over the same period by approximately $9 million. Therefore, FGT requested a predetermination that it may roll the costs of the Phase VII Expansion Project into its FTS-2 rates in a future rate proceeding.

5. In support of its request, FGT maintained that the Phase VII Expansion Project would constitute cheap expansibility made possible by its 1993 Phase III Expansion Project, and on that basis would qualify for rolled-in rate treatment.[2] The Phase III Expansion Project involved a major addition to the FGT system, including installing over 800 miles of new pipe. In a settlement agreement addressing Phase III Expansion Project issues, FGT and its customers affirmed that the Phase III Expansion Project would provide cheap expansibility for FGT's Incremental System in the future. The 1993 settlement required the costs of any future expansion to be rolled into the costs of the Incremental System, provided the application was filed with the Commission prior to July 1, 1998.[3]

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[2] *See Florida Gas Transmission Co.*, 62 FERC ¶ 61,024 (preliminary determination), *order granting and denying reh'g and granting clarification*, 63 FERC ¶ 61,093, *order issuing certificates, authorizing abandonments, and clarifying prior order*, 64 FERC ¶ 61,288 (1993), *order granting reh'g in part and granting clarification,* 66 FERC ¶ 61,160 (1994).

[3] 62 FERC ¶ 61,024 at 61,176 and 61,181 (1993).

6. FGT stated that although this settlement provision expired before it filed applications for its Phase IV, V, and VI Expansion Projects,[4] FGT's last rate proceeding rolled the costs and billing determinants of those expansion projects into the rates for service under Rate Schedule FTS-2.[5] Similarly, FGT asserted that rolling the Phase VII Expansion Project's costs into its FTS-2 rates would not adversely affect the maximum rate for service under Rate Schedule FTS-2.

7. In the June 2006 Order, the Commission denied FGT's request, finding that it would be "premature to make a predetermination on rolling in the proposed expansion's costs because FGT could file its next rate case before project revenues exceed costs on an annual basis."[6] Comparing the period between May 1, 2007 and April 30, 2010, a period during which the project's annual costs are projected to exceed its revenues, to the period during which FGT must file its next general rate,[7] the Commission found it likely that in FGT's next rate case, test period data would reflect that the project had not achieved financial viability. Under such circumstances, rolling in the project's costs would result in existing FTS-2 customers subsidizing the project from the date the new FTS-2 base rates become effective until the time that FGT makes a subsequent NGA section 4 rate filing.

8. In the June 2006 Order, the Commission observed that "[d]enying the predetermination requested by FGT will not preclude FGT from the opportunity to demonstrate in its next rate case that Phase VII Expansion costs can be rolled into its FTS-2 rates without a subsidy from existing customers. However, FGT will bear the

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[4] *See*: FGT's Phase IV Expansion Project, 88 FERC ¶ 61,142 (1999) (preliminary determination), o*rder issuing certificate,* 90 FERC ¶ 61,212 (2000); FGT's Phase V Expansion Project, 93 FERC ¶ 61,203 (2000) (preliminary determination), o*rder issuing certificate and granting abandonment authorization,* 96 FERC ¶ 61,151 (2001); and FGT's Phase VI Expansion Project, 98 FERC ¶ 61,127, *order issuing certificate,* 99 FERC ¶ 61,311 (2002).

[5] 109 FERC ¶ 61,320 (2004).

[6] 115 FERC ¶ 61,328, P 42 (2006).

[7] In FGT's latest general rate case settlement in Docket No. RP04-12, Articles IX and XII of the settlement state that FGT must not file to increase its base tariff rates prior to October 1, 2007, but must file a general rate case under section 4 of the NGA no later than October 1, 2009.

burden of proof in demonstrating that rolled-in rate treatment is just and reasonable."[8] The Commission accepted FGT's currently effective FTS-2 rates as initial rates for the expansion project, pending FGT's next general rate filing.[9]

FGT's Request for Rehearing

9. FGT requests rehearing, claiming that in denying its request for a predetermination on the treatment of its expansion project costs, the Commission erred (1) by not following its own precedent and policy because its analysis failed to consider the impact of the project's fuel savings on existing customers; (2) by ignoring the fuel savings provided to existing customers as a result of FGT replacing an existing gas-fired compressor with a more efficient electric-powered compressor as part of the Phase VII Expansion Project's construction; and (3) by failing to consider that during the project's third year of operation, the fuel savings provided to existing FTS-2 customers by the project's compression modifications would greatly exceed any revenue shortfall associated with project during that period. FGT concludes that as a result of such errors, the June 2006 Order does not reflect reasoned decision making because the Commission's concern as to a possible subsidy does not exist for any rate case filed on or after April 1, 2009. Therefore, FGT requests rehearing only with respect to a general rate case FGT might file on or after April 1, 2009.

10. Specifically, FGT maintains that Exhibit N of its application shows that existing customers would experience a significant fuel savings resulting from the project in Year 3 of its operation. In its rehearing request, FGT uses data from Exhibit N to derive the value of this savings as nearly $1 million, which FGT states would more than offset the project's revenue shortfall of $260,183 in Year 3. Further, FGT maintains that a test period for any rate case filed on or after April 1, 2009, would span Year 3 of the expansion project's operations and therefore would not constitute a subsidy by existing customers. FGT notes that the adjustment period of such a test period would extend until September 30, 2009, and would consequently include service for the entire Year 3 summer season.

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[8] 115 FERC ¶ 61,328, P 43 (2006). In the *Certification of New Interstate Natural Gas Pipeline Facilities (Policy Statement on New Facilities),* 8 FERC ¶ 61,227 (1999); *clarifying statement of policy,* 90 FERC ¶ 61,128 and 92 FERC ¶ 61,094 (2000), the Commission stated that in considering a proposed project, the threshold requirement is that the project sponsor must be financially prepared to support the project without relying on subsidization from existing customers.

[9] The Commission noted that its decision was consistent with the action in *Eastern Shore Natural Gas Company*, 111 FERC ¶ 61,479 (2005), which denied a predetermination of rolled-in rate treatment because, during the test period in Eastern Shore's next required general rate case, the project's costs would exceed its revenues.

11. In its rehearing request, FGT contends that Exhibit N of its application demonstrates that a fuel savings of 882 MMBtu/d for existing mainline customers will result from the expansion project's replacement of a 7,200 hp gas-fired compressor with a 15,000 hp electric-powered compressor at Compressor Station 26. FGT derives this volumetric savings by comparing the daily cost of electricity required to run the new compressor with the daily quantity of gas required to fuel the existing gas-fired compressor – multiplying the projected fuel savings of 882 MMBtu/d times the 153 days of its summer season service, and multiplying the resulting seasonal volumetric savings of 134,946 MMBtu times a cost-of-gas price of $7.358 per MMBtu, to equal a cost savings of $996,576. FGT uses a gas commodity price of $7.385/MMBtu because in Exhibit N it used that price to convert an estimated seasonal cost of $2,328,398 to run the electric compressor into comparable gas volumes in order to demonstrate the cost savings. According to footnote 4 of Exhibit N, the estimated gas cost of $7.385/MMBtu is FGT's average cash-in/cash-out price for January through August 2005.

12. FGT claims that the June 2006 Order "recognize[d] that the Phase VII Expansion would result in fuel savings to existing customers."[10] FGT further claims that by failing to consider the impact of fuel savings on existing customers, the Commission's analysis did not follow its own policy and precedent, citing *Northern Border Pipeline Company* (*Northern Border*).[11] According to FGT, "[t]he Commission found that Northern Border was 'correct' in its argument that 'fuel-related impacts associated with construction projects must be considered as part of the 'no-subsidy' comparisons required under the Policy Statement."[12]

<u>Commission Response</u>

13. In the June 2006 Order, the Commission did not preclude FGT from requesting rolled-in rate treatment for the Phase VII Expansion Project; rather, the Commission declined to reach a predetermination on rate treatment because the proposed project was expected to incur costs in excess of revenues during the potential test period in FGT's next rate case. The Commission affirms its rejection of FGT requested predetermination

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[10] FGT's Request for Rehearing at 4, *quoting* the June 2006 Order, 115 FERC ¶ 61,328, P 33 (2006).

[11] 112 FERC ¶ 61,196 (2005). In addition to *Northern Border*, FGT cites several cases in which the Commission found that when a proposed project will result in an increase in fuel charges for existing customers, the additional fuel costs must be accounted for as a cost of the proposed project.

[12] FGT's Request for Request at 4, *citing Northern Border*, 112 FERC ¶ 61,196, P 22-23 (2005), referring to the Commission's *Policy Statement on New Facilities* referenced in note 9.

because the size of the revenue shortfall was, and continues to be, unknowable and dependent upon the date that a future NGA section 4 rate proceeding may be initiated.

14. FGT maintains that in the June 2006 Order, the Commission "recognized" the fuel savings to existing customers that would result from the Phase VII Expansion Project, quoting the Commission's observation in the order that "[a]ccording to page 3 of Exhibit N, the resulting summer season total mainline fuel use will be reduced from 3.44 percent to 3.17 percent once the proposed Phase VII Expansion is fully operational."[13] Although referring to FGT's Exhibit N, the Commission offered no comment on the validity of FGT's calculations, in part because FGT did not – until now – rely on fuel savings to support its requested predetermination, and also because the data in Exhibit N, due to various uncertainties described below, was of questionable value for determining whether to issue such a predetermination.

15. FGT alleges that the Commission failed to follow its own precedent in not taking into account the impact of fuel savings in considering FGT's requested predetermination. While citing several cases involving the impact of fuel use on rates, FGT relies primarily on *Northern Border* in arguing that Commission policy requires that fuel savings for existing customers be taken into consideration in deciding whether a proposed project merits a predetermination favoring rolled-in rate treatment.

16. In *Northern Border,* the pipeline requesting a predetermination regarding a proposed project's costs asked the Commission to consider fuel cost savings as a "value of in-kind fuel benefit" on the revenue side of a cost/revenue comparison in which costs greatly exceeded revenues. The Commission noted that none of the cases cited by Northern Border to support its request "address in-kind fuel as 'revenue,' . . . nor a pipeline's use of the value of fuel recovered from expansion shippers to offset what would otherwise be a shortfall in project revenues as opposed to project costs."[14] Nevertheless, the Commission acknowledged that it had "previously determined that an increase in fuel costs should be included in the rolled-in rate analysis," and consequently stated that "[i]t may well be appropriate likewise to consider reduced fuel costs when evaluating the project's impact on existing customers."[15] The Commission did so, but denied the requested predetermination based on the pipeline's failure to provide adequate support for its assertion that fuel provided by expansion shippers would offset the revenue

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[13] *Id., citing* 115 FERC ¶ 61,328, P 33 (2006)

[14] 112 FERC ¶ 61,196, P 22 (2005).

[15] *Id.,* P 23.

shortfall. Contrary to Northern Border's assertion, the Commission found that the proposed expansion project could add costs attributable to company-use gas that existing customers would have to have to bear. Of particular relevance, the Commission pointed out that Northern Border's calculated fuel savings was based on a single day's fuel price, which due to the volatility of natural gas prices, was not a sufficiently reliable indication of in-kind fuel contribution.

17. Consistent with the reasoning and result in *Northern Border*, the Commission finds that FGT has not provided adequate support for its assertion that fuel savings will offset the amount by which project costs will exceed project revenues. The Commission finds the data in Exhibit N of FGT's application, upon which FGT's rehearing request relies for its fuel savings calculations, to be insufficient to ensure that rolling in Phase VII Expansion Project costs in a rate case filed on or after April 1, 2009, will not adversely impact existing FTS-2 customers. For example, FGT calculates the conversion of electric compressor costs to comparable gas volumes in Exhibit N by dividing a commodity gas price – a price based on an average of gas costs from January through August 2005 – into FGT's estimate of $2,328,398 to run the new electric-powered compressor during a summer season. FGT does not explain the use of an averaged gas price spanning both summer and winter seasons to calculate a summer season's fuel savings, and does not provide any basis for its estimate of $2,328,398 to run a new electric-powered compressor during a summer season.

18. The Commission questions the accuracy of FGT's estimated costs, given the potential volatility of wholesale electric prices and the fact that FGT would not be filing a rate case covering its Phase VII Expansion Project costs until at least two-and-a-half years from now. Price volatility is illustrated by the fact that average electricity spot prices at Florida pricing points in proximity to FGT increased significantly in the summer of 2006 over prices during a similar period in 2005. Moreover, the uncertainty of electricity price volatility is compounded by volatility in the price of gas, the second variable FGT used in its calculations of fuel savings. Such commodity price volatility was recognized by the Commission in *Northern Border*.

19. In view of the uncertainty associated with the potential volatility in both gas and electric prices during the period between now and April 2009, the Commission affirms the June 2006 Order's determination that at this time it would be premature and speculative to provide a predetermination favoring rolling FGT's expansion project's cost into FTS-2 rates. Therefore, FGT's request for rehearing is denied. As noted, at the time of FGT's next rate proceeding addressing expansion costs, FGT may seek rolled-in rate treatment based on then-current actual data, adjusted for near-term prospective costs and revenues.

<u>The Commission orders</u>**:**

FGT's request for rehearing is denied, for the reasons discussed in the body of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.