

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

High Island Offshore System, L.L.C.

Docket No. RP03-221-007

ORDER ON CLARIFICATION AND REHEARING

(Issued December 16, 2005)

1. On August 8, 2005, High Island Offshore System, LLC (HIOS) filed a request for clarification and rehearing of the Commission's order¹ issued in this general section 4 rate case on July 7, 2005. The order issued on July 7, 2005 denied rehearing of the Commission's January 24, 2005 Order in this proceeding,² and accepted a compliance filing with conditions. For the reasons stated below, we grant in part and deny in part the requests.

I. Background

2. HIOS provides these transportation services to shippers: (1) firm, long haul service under Rate Schedule FT-2; (2) an interruptible long haul service under Rate Schedule IT; and (3) an interruptible short haul service also under Rate Schedule IT. On December 31, 2002, HIOS filed revised tariff sheets proposing to increase its rates pursuant to section 4 of the Natural Gas Act (NGA).³ Before this rate case filing, HIOS' long-haul volumetric rate under Rate Schedule FT-2, as well as its Rate Schedule IT rate, was 12.44 cents per Dth. The short haul volumetric rate was 4.99 cents per Dth. In this rate case, HIOS proposed to increase the Rate Schedule FT-2 long haul volumetric rate to 16.16 cents per Dth and the IT long haul rate to 17.59 cents per Dth.

3. On January 30, 2003, the Commission accepted and suspended the tariff sheets to be effective July 1, 2003, subject to refund and the outcome of the hearing. Following

¹ *High Island Offshore System, LLC*, 112 FERC ¶ 61,050 (2005).

² *High Island Offshore System, LLC*, 110 FERC ¶ 61,043 (2005).

³ *High Island Offshore System, LLC*, 102 FERC ¶ 61,088 (2003).

the hearing, the ALJ issued an initial decision on April 22, 2004.⁴ The ALJ's decision would have resulted in long haul volumetric rates of 8.56 cents per Dth. HIOS, Indicated Shippers and ExxonMobil filed exceptions.

4. On January 24, 2005, the Commission adopted the ALJ's decision on all rate issues except for an increase in the allowed management fee and a change in the computation of the federal income tax allowance. The Commission stated that its decision would result in just and reasonable base rates for HIOS substantially below its pre-existing rates, but the Commission did not calculate those rates. Pursuant to section 5 of the NGA, the Commission's order also required HIOS to revise its tariff to include an annual fuel and LAUF tracker with a true-up mechanism. The Commission stated it was adopting the "just and reasonable rates effective on the date of this order."⁵ Ordering paragraphs (C) and (D) of the order required HIOS to file tariff sheets to comply with the order within 21 days, and to refund to shippers all charges collected subject to refund, pursuant to the Commission's regulations, within 30 days of the date of the issuance of the order.

5. On February 14, 2005, HIOS submitted a compliance filing. The compliance filing included a tariff sheet reducing its long haul transportation rates to the pre-existing level of 12.44 cents per Dth, effective on July 1, 2003, the date its proposed rate increases had gone into effect. The compliance filing also included a *pro forma* tariff sheet further lowering HIOS' long haul transportation rate to 9.18 cents per Dth,⁶ and HIOS requested an effective date of the first day of the month following Commission acceptance of the compliance filing for that tariff sheet. HIOS also filed *pro forma* tariff sheets to establish an annual fuel adjustment and true-up mechanism, and proposed to collect an initial true-up component of 1.30 percent, which reflected its calculation of the prior undercollections of fuel, and a carrying charge associated with those volumes, under its pre-existing fuel charge mechanism.

6. The Commission's July 7, 2005 Order denied rehearing of the January 24, 2005 Order. The Commission also accepted the tariff sheet in HIOS' compliance filing reducing the long haul rate to its preexisting 12.44 cents per Dth level, effective July 1, 2003, the date its rate increase had gone into effect. With respect to the *pro forma* tariff sheet reflecting the further reduction in HIOS' base rates which the Commission ordered

⁴ *High Island Offshore System, LLC*, 107 FERC ¶ 63,019 (2004).

⁵ *High Island Offshore System, LLC*, 110 FERC ¶ 61,043 (2005) at P 1.

⁶ See HIOS' compliance filing of February 14, 2005 at 2.

pursuant to NGA section 5, the Commission directed HIOS to file an actual tariff sheet, to become effective on January 24, 2005, the date of the order taking the section 5 action. The order also directed HIOS to make a revised compliance filing of its fuel and LAUF gas tracker to eliminate from the true-up component of its proposed mechanism the provision for recovering its asserted undercollection of fuel under its existing tariff provision. The Commission also directed HIOS to file revised tariff sheets in place of the remaining *pro forma* tariff sheets, reflecting the Commission's findings regarding the fuel issues and fuel charges for the prospective period addressed on rehearing, to become effective on the first day of the month after the order issues, *i.e.*, August 1, 2005. On July 22, 2005, the Commission issued an order denying HIOS' motion for stay but granted its request for an extension of time to make refunds of the amount collected from its shippers in excess of the rates set by the January 24, 2005 Order from that date until August 1, 2005, but denied its request for stay of the requirement for a tariff compliance filing, as specified in the July 7, 2005 Order.⁷

II. Requests for Clarification and Rehearing

7. On August 8, 2005, HIOS requested clarification of the Commission's order regarding what over and under collections of fuel HIOS will be required to true up when it makes its second annual fuel tracker filing under the new fuel mechanism, which will be effective April 1, 2006. HIOS requests that the Commission clarify that the over or under collections to be trued up will only be those occurring during the period commencing August 1, 2005 rather than the entire calendar year 2005. In the alternative, HIOS requests rehearing on this issue.

8. In its request for rehearing, HIOS argues that the Commission acted in contravention of NGA section 5 when it made the section 5 reduction in HIOS' base rates effective as of the date of the January 24, 2005 Order and that the Commission failed to consider equitable factors that would have relieved HIOS of refunds for those rates for services performed between January 24, 2005 and July 7, 2005, when the Commission issued its order on HIOS' compliance filing.

9. HIOS also claims the Commission abused its discretion contrary to NGA section 5 in rejecting an initial transitional true up of past undercollections of company use gas

⁷ *High Island Offshore System, LLC*, 112 FERC ¶ 61,087 (2005). These compliance tariff sheets were accepted by the Commission on November 23, 2005. *High Island Offshore System, LLC*, 113 FERC ¶ 61,202 (2005).

currently carried on HIOS' books.⁸ HIOS further argues that the Commission's failure to allow HIOS to collect past undercollections violates the filed rate doctrine and is contrary to policy and precedent.

10. HIOS also asserts that the Commission abused its discretion when it failed to invite HIOS to prepare an alternative method for fuel charges which would have allowed HIOS to remain whole respecting fuel underrecoveries.

III. Answer to Requests

11. ExxonMobil on August 23, 2005 filed a motion for leave to answer and an answer to HIOS' request for clarification and rehearing. ExxonMobil does not oppose the request for clarification but objects to the request for rehearing. Our rules, sections 385.212 and 385.213, permit answers to motions; but, section 385.213(a)(2) prohibits answers to requests for rehearing unless specifically authorized by the Commission. Accordingly, only that part of ExxonMobil's motion which addresses the request for clarification can be accepted for consideration.

IV. Discussion

For the reasons discussed below, the Commission grants HIOS' request for clarification. The Commission denies in part and grants in part HIOS' request for rehearing.

A. Request for Clarification of Period for Computing Over or Underrecoveries

12. HIOS requests clarification that the time period to be used in its April 1, 2006 filing, for the purpose of true-up for over or undercollections of fuel charges, be set at August 1, 2005 to December 31, 2005, rather than the 12 months of calendar year 2005. ExxonMobil stated in its answer that it does not oppose the request for clarification. HIOS argues that the only period of time during which its fuel tracker mechanism should be in effect should be limited to the period starting August 1, 2005 when the fuel tracker with an annual true up was implemented. HIOS' request for clarification appears to be

⁸ The initial true-up factor of 1.30 percent proposed by HIOS was estimated to recover \$16.3 million in equivalent costs to shippers. *High Island Offshore System, LLC*, 112 FERC ¶ 61,050 at P 138.

reasonable and is granted for the first year of the annual tariff filing. After 2006, HIOS must employ the full 12 months of the previous calendar year as a base period for the true up of over or under collection of fuel charges.

B. HIOS' Proposed Carryover Of Undercollected Fuel Charges

13. The second issue raised by HIOS addresses the matter of carrying over its asserted undercollection of fuel charges from the pre-existing fuel mechanism to the currently effective mechanism. HIOS argues that the new fuel recovery mechanism, as directed by the Commission, does not keep it whole, whereas its pre-existing mechanism would have done so. HIOS claims it has been barred from recovery of its costs by the Commission's refusal to allow its proposed initial transitional true-up of 1.3 percent to be collected from current and future ratepayers. HIOS states the record shows HIOS experienced a temporary period of under recovery of its company use gas.⁹ HIOS states that, under its old mechanism for recovering fuel costs, it had incurred an accumulated underrecovery of 3.7 Bcf as of May 2003, but had reduced that underrecovery to 2.7 Bcf as of May 2005. HIOS asserts that if the Commission had not acted under NGA section 5 to modify HIOS' fuel recovery mechanism, it could have recovered its asserted undercollections and thus it claims the record supports the proposed transitional true-up it requested.

14. HIOS argues that a pipeline must not be barred from recovery of its costs, as to do so otherwise would be confiscatory. HIOS asserts that the exclusion of the recovery of its past fuel and LAUF gas costs would result in a below the line monetary loss. HIOS argues that the Commission failed to address record evidence that HIOS had a historical undercollection of fuel and failed to address why it was no longer recoverable or why HIOS' shippers should receive a windfall.

15. HIOS claims the Commission erred in finding¹⁰ that HIOS was forbidden to surcharge to collect under recoveries incurred prior to the Commission's section 5 action because it contained no true-up for past underrecoveries and the statement that such an allowance would violate the filed rate doctrine and constitute retroactive ratemaking. HIOS argues that its pre-existing fuel mechanism was a "tracker," contrary to the Commission's finding.

⁹ HIOS references Tr. 811 and Tr. 853, which refer to exhibits introduced by the shippers as Exh. IND-35 and Exh. IND-38.

¹⁰ HIOS cites *High Island Offshore System, LLC*, 110 FERC ¶ 61,043 at P 120.

16. HIOS argues that the Commission's decision to disallow the 1.3 percent transition component in its tariff is contrary to the decision in *TransColorado*,¹¹ which allowed the pipeline to collect fuel undercollected for several years due to an accounting error. HIOS claims the customers had notice that the pipeline may make recovery of past underrecovered costs. HIOS claims its pre-existing tariff contemplated raising the fuel retainage percentage high enough to retire any existing undercollection on its books. HIOS argues that equity should allow it to obtain its one-time transitional true-up of 1.3 percent and the Commission is incorrect in stating that HIOS could have retained overcollections and absorb undercollections, and where HIOS claims the record shows HIOS had no over-recoveries. HIOS also claims that it purchased gas in order to replace undercollected volumes and has absorbed the carrying cost of this purchased gas.¹²

17. HIOS also argues that the Commission failed to suggest alternatives to be kept whole if it is not allowed the transitional true-up.

Commission Decision

18. The Commission reaffirms its holding that HIOS' proposal to include an initial transitional true-up fuel retention percentage of 1.3 percent in its new fuel recovery mechanism violates the filed rate doctrine and rule against retroactive ratemaking. By HIOS' own account in its rehearing request, the purpose of its proposed transitional true-up fuel retention percentage is to recover fuel costs¹³ which it incurred during a past period ending May 2003.¹⁴ Since fuel costs are variable costs, they are clearly incurred to provide service during the time period when they are incurred. Thus, there is no question that HIOS incurred the costs at issue here in order to provide service during the past period ending in May 2003. The United States Court of Appeals for the District of

¹¹ *TransColorado Gas Transmission Company*, 112 FERC ¶ 61,135 at P 6 (2005) and *Mississippi River Transmission Corp.*, 96 ¶ 61,185 at 61,817 (2001).

¹² HIOS request for clarification and rehearing at 33. HIOS states the May 2005 balance of the cost of underrecoveries is \$11,221,685 for the period October 2000 through May 2005.

¹³ In this order, for convenience the term "fuel costs" includes both the cost of the fuel that HIOS consumes to run its system and the cost of lost and unaccounted for gas.

¹⁴ See HIOS rehearing request at 21-22, stating that as of May 2003 it had incurred a total underrecovery of fuel costs of 3.7 Bcf, and since that time it has overrecovered its fuel costs, thus reducing its net underrecovery to about 2.7 Bcf as of May 2005.

Columbia Circuit has held, “Our cases establish that a pipeline may recover from a customer costs that the pipeline incurred in the past in order to provide service in the past only if the customer (1) has sufficient notice that it was liable for those costs, or (2) is given notice that future purchases will carry a surcharge.” *Panhandle Eastern Pipeline Co.*, 95 F.3d 62, 68 (D.C. Cir. 1996), and cases cited. Hence, we look to HIOS’ tariff in effect during the past period when these costs were incurred to determine whether it gave HIOS’ customers any notice that they would be held liable in the future through a surcharge or otherwise for costs incurred in providing past service.

19. During the period at issue here, section 1.6 of HIOS’ GT&C governed the amount of fuel that HIOS could retain to recover its fuel costs. Section 1.6 of the GT&C in HIOS’ tariff based the level of this retention on the ratio of HIOS’ total system fuel use and lost and unaccounted for gas during the preceding three calendar months to HIOS’ total received volumes during the preceding three calendar months. The tariff did not expressly set forth any specific fuel retention percentage calculated pursuant to this formula. Instead, HIOS was free to post the applicable percentages on its website, as they might change from month to month.¹⁵

20. We recognize that this tariff provision permitted HIOS to track changes in its fuel costs outside of its general section 4 rate cases. However, it only authorized such changes to be tracked on a prospective basis, so that the fuel retention percentage in effect after HIOS posted a change would more accurately recover fuel costs incurred to perform service after the posted change. Section 1.6 contained no provision for truing up HIOS’ over or under collections of fuel during periods before it posted a change in its fuel retention percentage. All that section 1.6 provided is that, if changes in HIOS’ fuel costs and received volumes over any three-month period led to either an increase or a decrease in the fuel retention percentage, as calculated pursuant to the formula in that section, HIOS could post a revised fuel retention percentage to be in effect prospectively in following months. Section 1.6 expressly stated “the intent” of this formula to be “that the ratio used best *projects* HIOS’ actual compressor fuel and Unaccounted For Gas volumes [emphasis supplied].” The tariff’s description of its formula as a projection of HIOS’ fuel costs demonstrates that the purpose of permitting HIOS to change its posted fuel retention percentage was to help make that percentage more closely match the fuel costs HIOS would incur during the prospective period when the revised retention percentage was actually in effect. A “best projection” of future costs, by definition, should not include any component for truing up past under or over collections.

¹⁵ Exh. EM-1 at 5.

21. HIOS suggests that the fact it over recovered its fuel costs during the period May 2003 through May 2005, so as to reduce its net underrecovery from 3.7 to 2.7 Bcf shows that its current tariff provision was permitting it to true up its underrecoveries. HIOS asserts that, accordingly, if the Commission had not modified HIOS' tariff pursuant to NGA section 5, it would have been able ultimately to recover its net underrecovery from past periods. However, the fact HIOS may have overrecovered its fuel costs during the two-year period it points to does not show that its tariff provides for it to surcharge past underrecoveries. It only shows that, whatever the reason, the projections of future fuel costs, upon which the fuel retention percentages in effect during that period were based, proved, in hindsight, not to have been accurate.

22. We conclude that HIOS' tariff in effect during the pre-May 2003 period when it incurred the fuel costs at issue here provided no notice to its customers that they could be held liable for those costs in a future surcharge or otherwise. To the contrary, HIOS' tariff gave notice that the customers would not be subject to any such surcharge. In these circumstances, the precedent of the D.C. Circuit is clear that any effort to recover these past costs through a special surcharge, such as that proposed by HIOS, would violate the filed rate doctrine and the rule against retroactive ratemaking. *Transwestern Pipeline Co. v. FERC*, 897 F. 2d 570, 579-80 (D.C. Cir. 1990) (filed rate doctrine violated by direct billing costs incurred to provide service prior to notice that customer would be directly liable). *Panhandle*, 95 F.3d at 68-70 (filed rate doctrine violated by surcharge based on current contract demand to recover costs of providing past service before notice of surcharge).

23. HIOS argues that our action here is inconsistent with various other Commission orders in which the Commission granted the carryover of the undercollected fuel charges from prior years.¹⁶ We reject that argument because the principal precedent involved here sets forth the following test for recovery of past undercollections of fuel: "whether the pipeline may make prior period adjustments in its fuel tracker should largely depend upon two elements. First, the pipeline should only be permitted to recover losses related to prior period if the underlying tariff permits such recovery. . . .[and] if the tariff permits such a recovery, the pipeline must establish that the losses it alleges are the type for which recovery was contemplated. . . ."¹⁷ HIOS has failed to show that its pre-existing

¹⁶ HIOS cites *TransColorado Gas Transmission Company*, 112 FERC ¶ 61,135 (2005); *Mississippi River Transmission Corp.*, 96 FERC ¶ 61,185(2001); and *Northern Natural Gas Company*, 110 FERC ¶ 61,253 (2005) in its rehearing request.

¹⁷ *Mississippi River Transmission Corp.*, 96 FERC ¶ 61,185 at 61,817 (2001); accord *TransColorado Gas Transmission Company*, 112 FERC ¶ 61,135 at P 12-14 (2005).

tariff permits such recovery or that the losses it alleges were contemplated to be recovered. The other cases cited by HIOS all involved tariffs that were materially different from HIOS' tariffs. Specifically, the tariffs in the other cases included express provisions for the purpose of truing up past over and under collections of fuel costs, and the issue was whether those true-up tariff provisions extended to the particular past fuel costs at issue in those cases. By contrast, in the instant case, as discussed above, HIOS' tariff contains no such true-up provision and contains language stating its intent is to permit HIOS to recover projected costs.¹⁸

24. Moreover, our action here is also consistent with our order in *ANR Pipeline Company*,¹⁹ where we held that "the under-recoveries and over-recoveries to be trued up by the pipeline are only those accruing after the date of our section 5 action."²⁰ Accordingly, we find that the fuel mechanism in place for current and future filings may not include any carryover of asserted undercollections in prior years.

¹⁸ HIOS contends that our action in this case is also inconsistent with the Commission's orders in HIOS' Order No. 636 restructuring proceeding, where the Commission recognized that HIOS' tariff permitted it to track changes in its fuel costs between rate cases, but did not require HIOS to adopt a true-up mechanism. *High Island Offshore System*, 63 FERC ¶ 61,280 at 62,836 (1993). However, in 2004, after the orders in HIOS' Order No. 636 proceeding, the Commission modified its policy to require that, where the pipeline tracks changes in a particular cost between rate cases, its must contain a true-up mechanism. *ANR Pipeline Company*, 108 FERC ¶ 61,050 (2004), *order on rehearing and clarification*, 110 FERC ¶ 61,069 (2005), *order on rehearing and clarification*, 111 FERC ¶ 61,290 (2005). We are simply applying that change in policy in this proceeding. Moreover, HIOS did not seek rehearing of our order that it modify its tariff to include a true-up mechanism. HIOS also complains that we have imposed on it a true-up mechanism of our choice, without giving it discretion to offer alternative true-up methods. However, in the July 7, 2005 Order, the Commission made clear that it had exercised its section 5 authority only to order HIOS to include a true-up mechanism in its tariff, and that we were giving HIOS the initiative to propose the specific provisions of the required true-up mechanism. 112 FERC at P 114, 131. We have rejected its proposal to include recovery of pre-May 2003 undercollections, only because that proposal violates the filed rate doctrine.

¹⁹ *ANR Pipeline Company*, 108 FERC ¶ 61,050 (2004), *order on rehearing and clarification*, 110 FERC ¶ 61,069 (2005), *order on rehearing and clarification*, 111 FERC ¶ 61,290 (2005).

²⁰ *High Island Offshore System, LLC*, 110 FERC ¶ 61,043 at P 145.

C. Refund of Excess Charges

25. The third issue raised by HIOS concerns its objection to the requirement in the July 7, 2005 Order that the section 5 reduction in its rates from the preexisting level before this rate case to the new just and reasonable level determined by the Commission take effect on January 24, 2005, and the concomitant requirement that HIOS now refund to its shippers excess charges it has collected. HIOS argues that while it reduced its long haul rate to 12.44 cents per Dth effective January 1, 2003, the Commission's order requiring a 9.18 cent per Dth long haul rate, to be effective on January 24, 2005, would constitute retroactive ratemaking as the January 24, 2005 Order did not specify a rate to be observed from that date, but awaited submission of a compliance filing and approval of that filing before a reduced rate could become effective. HIOS argues that an order approving its compliance filing did not occur until July 7, 2005. HIOS agrees that effective August 1, 2005, it will charge the 9.18 cent per Dth rate for long haul transportation. HIOS stated it intended to refund to its shippers the amounts of the increased rates collected subject to refund from July 1, 2003 through December 31, 2004.²¹

Commission Decision

26. Upon consideration of the HIOS' contentions, the Commission grants the request for rehearing regarding the effective date of its section 5 action reducing HIOS' rate below their level before HIOS filed the instant rate case. The Commission's general practice in determining the effective date of rate reductions ordered pursuant to NGA section 5 has been to take either of the following two approaches. First, if the Commission is able to calculate the new just and reasonable rate itself, the Commission has done so and made the new rate effective either as of the date the order issues or the first day of the following month.²² Alternatively, if the Commission cannot reliably calculate the precise revised rates it is ordering the pipeline to adopt, the Commission has ordered the pipeline to calculate the revised rate in its compliance filing. In such

²¹ HIOS filed its refund report on September 8, 2005 in Docket No. RP03-221-008, stating that it had made refunds of \$17,171,205 to its shippers. No objection has been filed to its report. The report was accepted by an order issued on November 8, 2005.

²² See, e.g., *Indicated Shippers v. Sea Robin*, 79 FERC ¶ 61,072 at 61,361-2, *reh'g*, 81 FERC ¶ 61,146 at 61,659-60 (1997).

circumstances, the Commission has not made the revised rate effective until the Commission issued an order accepting the pipeline's compliance filing, thereby "fixing" the new just and reasonable rate for purposes of NGA section 5.²³

27. Here the Commission did not calculate the reduced just and reasonable rates in its January 24, 2005 Order. Therefore, consistent with our general practice, the Commission finds that July 7, 2005, the date the Commission accepted HIOS' compliance filing containing the new just and reasonable rates resulting from our section 5 action, is the appropriate effective date for the reduced just and reasonable rates in the circumstances here. Any rates HIOS collected in excess of the just and reasonable levels for service performed after July 7, 2005 must be refunded.

The Commission orders:

(A) HIOS' request for clarification and rehearing is granted in part and denied in part as set out in our order.

(B) The time period to be used by HIOS under section 28 of the General Terms and Conditions in its tariff in its April 1, 2006 filing, for the purpose of true-up for over or undercollections of fuel and LAUF charges, shall be August 1, 2005 to December 31, 2005, rather than the 12 months of calendar year 2005. In its annual filings, after its 2006 filing of proposed fuel and LAUF charges, HIOS must employ the full 12 months of the previous calendar year as the base period for the true-up of over or under collections of fuel and LAUF charges.

(C) Within 30 days of the date of issuance of this order, HIOS is directed to refund to its shippers all revenues collected in excess of the just and reasonable rates approved herein for the period July 7, 2005 to August 1, 2005, with interest, as specified in section 154.501 of the Commission's regulations.

By the Commission. Commissioner Brownell dissenting with a separate statement attached.

(S E A L)

Magalie R. Salas,
Secretary.

²³ See, e.g., *Williston Basin Interstate Pipeline Co.*, 69 FERC ¶ 61,360 at 62,362-3 and fn. 16 (1994).

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

High Island Offshore System, LLC.

Docket Nos. RP03-221-007

(Issued December 16, 2005)

BROWNELL, Commissioner, dissenting:

As I have previously stated, the appropriate course of action in this case would have been to approve the uncontested settlement.²⁴ For these reasons, I dissent from today's order.

Nora Mead Brownell
Commissioner

²⁴ *High Island Offshore System, L.L.C.* 110 FERC ¶ 61,043 (2005), *order on rehearing* 112 FERC ¶ 61,050 (2005).