UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, and Joseph T. Kelliher.

Transcontinental Gas Pipe Line Corporation — Docket No. RP01-245-000

ORDER ON INITIAL DECISION

(Issued March 26, 2004)

1. This order addresses exceptions to an initial decision on thirteen issues that were reserved for hearing by a settlement in Transcontinental Gas Pipe Line Corporation's (Transco) general Section 4 rate proceeding in Docket No. RP01-245-000. The order affirms in part and reverses in part the initial decision.

## I. Background

2. On March 1, 2001 Transco filed revised tariff sheets to reflect a general Natural Gas Act (NGA) Section 4 rate increase. Transco stated that its filing fulfilled its settlement obligation in Docket No. RP97-71-000 to file a general Section 4 rate increase to be effective no later than September 1, 2001. The proposed rates would have resulted in an annual revenue increase of approximately $227.8 million. On March 28, 2001, the Commission issued an order accepting and suspending the tariff sheets to be effective September 1, 2001, subject to refund and the outcome of the hearing established by the order.[1] On May 25, 2001, the Commission issued an order on rehearing of the March 28, 2001 order addressing whether the costs of certain expansion facilities should be subject to either rolled-in or incremental rate treatment.[2]

3. On March 1, 2001, Transco also filed, in Docket No. RP01-253-000, revised tariff sheets to change the fuel retention percentages applicable to transportation and storage rates for the next annual period with a proposed effective date of April 1, 2001. On

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[1] Transcontinental Gas Pipe Line Corporation, 94 FERC ¶ 61,360 (2001).

[2] Transcontinental Gas Pipe Line Corporation, 95 FERC ¶ 61,268 (2001).

March 28, 2001, the Commission issued an order accepting and suspending the tariff sheets, to be effective April 1, 2001, subject to refund and further review.[3] On July 30, 2001, the Commission issued an order consolidating the proceeding in Docket No. RP01-253-000 with Transco's ongoing rate proceeding in Docket No. RP01-245-000.[4] The Commission found that consolidation of the two proceedings would be the most efficient procedure for addressing all issues.

4. On April 12, 2002, in Docket No. RP01-245-007, et al., Transco submitted a stipulation and agreement to resolve, subject to certain reservation and adjustments, Transco's cost of service, overall throughput level and mix of throughput for the Docket No. RP01-245-000 rate period, i.e., from September 1, 2001, the earlier of (1) the effectiveness of Transco's next NGA Section 4 general rate case filing or (2) the effective date of a change to Transco's jurisdictional rates directed by a Commission order pursuant to NGA Section 5. Pursuant to Article VII of the stipulation, fourteen issues were reserved for resolution pursuant to hearing or further settlement. The settlement was certified by the Presiding Administrative Law Judge (ALJ) as uncontested. On July 23, 2002, the Commission issued a letter order approving the settlement.[5]

5. On July 10, 2002, in Docket No. RP01-245-011, Transco filed a stipulation and agreement to resolve one of the issues reserved pursuant to Article VII of the April 12, 2002 stipulation and agreement. The issue resolved was the design of the rate for service under Transco's Rate Schedule ISS (Interruptible Storage Service). The settlement was certified by the Presiding ALJ as uncontested. On September 23, 2002, the Commission issued a letter order approving the settlement.[6]

6. Hearings on the thirteen reserved issues were held on July 9, 2002, through July 31, 2002. Parties filed initial briefs on August 28, 2002, and reply briefs on September 17, 2002. On December 3, 2002, the Presiding ALJ issued an initial decision.[7] On December 12, 2002, the Presiding ALJ certified the initial decision and record to the Commission.

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[3] Transcontinental Gas Pipe Line Corporation, 94 FERC ¶ 61,347 (2001).

[4] Transcontinental Gas Pipe Line Corporation, 96 FERC ¶ 61,161 (2001).

[5] Transcontinental Gas Pipe Line Corporation, 100 FERC ¶ 61,085 (2002).

[6] Transcontinental Gas Pipe Line Corporation, 100 FERC ¶ 61,298 (2002).

[7] Transcontinental Gas Pipe Line Corporation, 101 FERC ¶ 63,022 (2002).

## II. Discussion

### A. Rights of FT Conversion Buyers

7. The first issue reserved by the settlement is what rights should the FT Conversion Buyers have upon expiration of their current FT service agreements. These customers are Transco's former bundled sales customers who converted to firm transportation service under Rate Schedule FT pursuant to settlement agreements approved by the Commission in 1991[8] before the issuance of Order No. 636. At the time of the settlements, Section 284.221(d) of the Commission's Part 284 regulations, as adopted by Order No. 436, authorized pre-granted abandonment under NGA Section 7 of all contracts upon expiration of the contract, with no right of first refusal (ROFR).[9] The 1991 settlements provided for the FT conversion shippers to be exempt from such pre-granted abandonment. Specifically, Article IV of the FT conversion shippers' contracts provides that (1) after their initial term, the contracts remain in effect until terminated by either party on three years notice, (2) pre-granted abandonment will not apply, and (3) Transco may not exercise its right to terminate as long as the shipper is willing to pay rates no less favorable than Transco is otherwise able to collect from third parties for such service. Thus, Transco cannot terminate service to an FT conversion shipper, without obtaining an individual grant of abandonment authorization from the Commission pursuant to NGA Section 7. The FT contracts also give the FT conversion shippers contractual entitlements on Transco's production area mainline,[10] as well as in its market area.

8. At the hearing, PSCNY and KeySpan claimed the contracts and tariffs are unjust and unreasonable because they lock conversion buyers into production area mainline

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[8] 55 FERC ¶ 61,446 (1991), order on reh'g, 57 FERC ¶ 61,345 (1991), order on reh'g, 59 FERC ¶ 61,279 (1992), aff'd in part and remanded, Elizabethtown Gas Co. v. FERC, 10 F.3d 866 (D.C. Cir. 1993).

[9] In Order No. 636, in order to protect captive customers, the Commission tempered the pipelines' pre-granted abandonment authority by giving shippers a right of first refusal upon expiration of their contracts. Ultimately, on remand of Order No. 637, the Commission determined that there should be no term matching cap for shippers exercising the right of first refusal under maximum rate contracts.

[10] Because the pipeline increases in size as it moves from the production area to the market area, "telescoped" rights refer to the increased amount of capacity available to shippers as the pipeline expands.

capacity indefinitely. PSCNY requested that conversion buyers at the end the primary terms of their contract be given the right to terminate the existing arrangements and to renominate for capacity with a ROFR. Under the PSCNY's ROFR proposal, at the end of the contract, a conversion shipper would state what capacity it wanted to keep, for example, it could state that it only wanted market area capacity. The pipeline would then post the capacity for third party bids. If a third party put in a bid for the production area and market area capacity, the existing shipper would have to match that bid for the whole path in order to exercise its ROFR. KeySpan argued that the conversion buyers are entitled to a ROFR because, while the service agreements state that Transco does not have pre-granted abandonment, it is silent on the issue of a ROFR. KeySpan proposed a ROFR process similar to that proposed by PSCNY.

9. The ALJ found that the contracts should not be modified because the parties failed to meet the public interest standard of the Mobile-Sierra doctrine.[11] The ALJ found that the FT conversion shippers freely entered into contracts that provided full abandonment protection under Section 7 of the NGA and did not seek a ROFR clause. The ALJ found that the FT conversion shippers are seeking to alter contracts that no longer fit their needs but it would be more appropriate for them to negotiate with Transco. The ALJ found that the parties were seeking flexibility on only one side of the agreement by requesting the full protection of no pre-granted abandonment, full protections of NGA Section 7, and a ROFR. The ALJ concluded that the parties had not met the public interest standard nor had they demonstrated that the existing contracts were unjust and unreasonable. Accordingly, the ALJ determined that no modification of the contracts or tariff was warranted.

10. KeySpan, PSCNY, and the Transco Municipal Group filed exceptions to the ALJ's holding on this issue. They argue that the ALJ erred in failing to require Transco to offer ROFR rights to the FT conversion shippers. They argue that the ALJ erred in finding that the ROFR proposal was a contract modification requiring a showing that it was in the public interest as required under the Mobile-Sierra standard. The parties argue that the FT conversion shippers are entitled to a ROFR, regardless of the fact that the service agreements provide Section 7(b) abandonment protection. The parties contend that the ALJ failed to recognize that Transco and the FT conversion shippers are not in an equal bargaining position with respect to contract renegotiation. They argue that their ROFR proposal is just and reasonable and is not a geographic ROFR, because shippers would be required to meet the best bid for the entire length of the capacity. The parties

[11] United Gas Pipe Line Co. v. Mobile Gas Services, 350 U.S. 332 (1956); FPC v. Sierra Pacific Power Co., 350 U.S. 348 (1956).

also argue that failure to offer a ROFR to the FT conversion shippers frustrates the goals of Order No. 636 by preventing the shippers from seeking new supply arrangements and inhibits the development of market centers. Transco filed a brief opposing exceptions.

**Commission Decision**

11. The Commission affirms the ALJ's finding that the existing contractual and tariff rights afforded to the FT conversion shippers are just and reasonable and warrant no modification. The Commission need not determine whether the Mobile-Sierra public interest standard is applicable in this proceeding, because the Commission finds that even using the Section 5 standard the parties want the Commission to use, they have not met their burden of showing the existing contracts are unjust and unreasonable.

12. The ALJ's decision is consistent with the stated purpose of the ROFR. In Order No. 636, the Commission stated that "[t]he exercise of the right of first refusal established in the final rule, that will apply after the restructuring proceedings are complete, will be a means of avoiding pre-granted abandonment, in the absence of contractual provisions to extend the contract duration." Order No. 636 at 30,448. Here, the Conversion Buyers need not avoid pre-granted abandonment because their contracts specifically provide that pre-granted abandonment does not apply. In Order No. 637, while the Commission narrowed the scope of the right of first refusal, the Commission recognized that "[t]his modification is consistent with the purpose of the right of first refusal to protect the historical service of long-term captive customers." Order No. 637 at 31,335. A ROFR is not needed to protect the historical service of the FT conversion shippers, because those services are protected by the FT conversion shippers' contractual rights requiring Transco to file an individual abandonment application with the Commission pursuant to NGA Section 7(b) before terminate their service. Under NGA Section 7(b), the Commission can only grant abandonment by finding, "after due hearing," that "the present or future public convenience or necessity permit such abandonment." To the extent the FT conversion shippers are still using their historical capacity to serve the needs of their customers, the Commission could not find that abandonment is in the public convenience and necessity. The Commission agrees with the ALJ that no further protections are required.

13. The Commission also finds that its decision here is consistent with its findings in other cases that the ROFR gives the shipper an opportunity to decide whether and how much of its capacity to retain, not only in light of the current market value of the capacity as shown by the third party bids, but also in light of a current assessment of its capacity needs. Texas Eastern Transmission Corp., 103 FERC ¶ 61,135 (2003) and Transco, 101 FERC ¶ 61,267 (2002). With respect to the conversion shippers here, termination of their contracts would occur only after an abandonment proceeding in which Transco filed

to abandon the full contract. In such a proceeding, the FT conversion shippers would have the opportunity to state that they still require a part of their capacity, but no longer need the remainder of their capacity and therefore desire the Commission to deny abandonment with respect to the part of their capacity they still need, but grant abandonment as to the remainder. The Commission would then consider all factors relevant to a determination of what abandonment is in the public convenience and necessity, and could grant a partial abandonment, where consistent with the Commission's policies concerning termination of existing shippers' long-term contracts.

14. Further, even if the Commission would require Transco to give the FT conversion shippers a ROFR, it would not be in the form that they are requesting. Those shippers propose that they be given an opportunity to reduce their contracts both volumetrically and geographically. Under their proposal, the FT conversion shippers would only have to retain the entire length of their contract capacity if a third party was willing to bid for the entire path. However, under the ROFR provided under the Commission's regulations, the pipeline need not give shippers any opportunity to reduce the geographic length of their capacity, regardless of whether there is a third party bid for the entire contract path. The FT conversion shippers argue that the ROFR is necessary because they otherwise are permanently locked into telescoped production area capacity. Such a situation was specifically addressed by the Commission in Order No. 637 where it rejected a geographic ROFR. The Commission stated:

> Order No. 636 did not include within the right of first refusal the option to contract for a geographic portion of the historical capacity, and permitting an existing shipper to exercise its right of first refusal for a geographic portion of its historical service is not consistent with its purpose. A shipper that can terminate a geographic portion of its historical service must have alternatives in the marketplace that can substitute for its historical service, and therefore is not a captive customer that requires the protection of the right of first refusal. In its comments, Con Ed gives an example of a shipper that has a contract for service from the pipeline's production area to points in the market area, and argues that the shipper should be able to retain its right of first refusal to capacity in the market area without being required to retain capacity in the production area. In this example, the shipper clearly has competitive options for transporting its gas and does not need the protection of a right of first refusal to protect its historical service.

15. Thus, the ROFR sought by the FT conversion shippers is not consistent with current Commission policy. The Commission accordingly affirms the ALJ's rejection of the proposal to modify the FT conversion shippers' contracts.

**B**. **Replacement Shippers' Ability to Contingency Rank Services**

16. The next issue reserved by the settlement concerns the scope of shippers' rights to "contingency rank" their services. Contingency ranking is a means of allocating to particular shippers and services any differences between actual deliveries at a point and the amounts that were scheduled to be delivered. This enables Transco to bill shippers appropriately for services received[12] and determine who may incur penalties or must cash out imbalances.

17. There is a single operator of each of Transco's delivery points, generally a shipper on the system rather than Transco itself. If the facilities downstream of the delivery point are owned by a local distribution company, that LDC generally operates the delivery point. Both the delivery point operator and other Transco customers (third parties) may seek to schedule deliveries at a delivery point. As part of the scheduling process, the delivery point operator must confirm and rank the various transactions that are scheduled for delivery at the point. The operator ranks the scheduled transactions from first (higher) through the delivery point to last (lower). Generally, the higher ranked the transaction, the less chance that there will be differences between the scheduled and actual deliveries for that particular transaction. The delivery point operators usually rank the scheduled transactions of other customers (third parties) first, followed by their own transactions, and then any transaction that is designated as "taking the swing," i.e., the transaction to which differences between scheduled and actual deliveries at the point will be attributed. Ex T-52 at 6.

18. The delivery point operator also provides Transco a pre-determined contingency ranking of services that may be used after the gas day has ended to account for any difference between scheduled and actual deliveries. These services need not be services for which a transaction was scheduled in the day in question. For example, a no-notice shipper may use several different storage services to manage variations between its scheduled and actual deliveries. Such a storage service could be designated for use in accounting for variances from scheduling amounts, even though no such service had been scheduled. In such a circumstance, Transco would treat excess deliveries as a withdrawal from the relevant storage service and underdeliveries as a storage injection.

19. Section 18.1 of Transco's GT&C addresses contingency ranking and, as of the time of the hearing, read as follows:

[12] Transco bills shippers based on actual deliveries rather than scheduled amounts.

> Each entity downstream of Seller which takes gas quantities from Seller's system (downstream entity) shall, in accordance with the nomination and ranking deadlines, set forth in section 28.1 of the General Terms and Conditions, provide Seller (or cause the interconnecting downstream entity to provide Seller, if applicable) with a predetermined allocation methodology for measured quantities (based on scheduled quantities) at the point(s) of delivery where Seller tenders gas to such downstream entity. Such allocation methodology may be changed for any prospective day during a month. Such downstream entity shall be required to designate which services are to "take the swing" on any day that measured delivered quantities are greater than or less than the scheduled quantities for such day, including (1) identification of the "swing supplier(s)" under transportation services, (2) the priority ranking of "swing" storage services (scheduled or unscheduled) including "swing supply" withdrawals from and/or injections into third party storage facilities directly connected to Seller's system, and (3) the services to which any overruns under this section 18 will be allocated.

20. In Transco's Order No. 637 proceeding, the Commission approved a revision to section 18.1 to replace "downstream entity" with "delivery point operators." Fifth Revised Sheet No. 276 was accepted to effective April 1, 2003. SCANA did not object to such revision. 102 FERC ¶ 61,308.

21. At the hearing, SCANA sought a modification to Transco's tariff to ensure that all shippers, including replacement shippers, were eligible to contingency rank their storage assets and not just delivery point operators.[13] SCANA argued that contingency ranking was critical to marketers in Georgia to maximize the efficient use of their upstream rights. SCANA is a marketer in Georgia that gets released capacity from AGL, who is the LDC with the no-notice service on Transco as well as the delivery point operator. SCANA wants the same ability to contingency rank its storage assets for no-notice

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[13] SCANA proposed the following changes to section 18.1 which are highlighted in bold:

The downstream entity, **after consulting with all shippers and/or replacement shippers scheduling quantities to its delivery point,** shall be required to designate **for each shipper and/or replacement shipper** which services are to "take the swing" on any day that measured quantities are greater than or less than the scheduled quantities for such day.

service just as AGL has. SCANA asserted that Order No. 637-A mandates scheduling equality among releasing and replacement shippers in regard to no-notice scheduling rights and contingency ranking. Transco argued that contingency ranking is not an aspect of no-notice service. Transco further asserted that contingency ranking is not a universal right of firm shippers on the Transco system, but is something only performed by delivery point operators. Transco stated that it relies on each delivery point operator to confirm and rank all gas that leaves Transco's system, because custody of gas is transferred from Transco to the delivery point operator when it leaves Transco's system. Transco therefore has structured its business practices and systems based on the concept that the delivery point operator is responsible for allocating gas that leaves the system at its delivery point. Therefore, a releasing shipper who is not a delivery point operator has no contingency rights.

22. The ALJ found that Transco must modify its existing tariff to provide replacement shippers with the right to contingency rank with respect to no-notice service. The ALJ stated that Order No. 637-A held that "[t]here should be no operational reason why the pipeline should limit the release of no-notice service or place restrictions on the released service that do not apply to the releasing shippers." Order No. 637-A, FERC Stats. & Regs. [Regs. Preambles 1996-2000] ¶ 31,098 at 31,548 (2000). The ALJ went on to say that the Commission stated that the pipeline will not be providing any additional service that it did not originally contract for by providing contingency ranking rights to replacement shippers. The ALJ determined that nowhere in Transco's tariff is it designated that those who receive contingency ranking rights must be delivery point operators. The ALJ found that the data exists for Transco to determine the volumes delivered to replacement shippers at the city gate. The ALJ stated that, as SCANA pointed out, the market share calculations AGL collects pursuant to its tariff would provide the necessary information for Transco to capture the actual flows at the city gate and the volumes attached to each replacement shipper. The ALJ concluded that although it may be complex to install, Transco must be fair to all its shippers and grant each shipper contingency ranking rights on its system, and implement a system to do exactly that.

23. On exceptions, Transco and AGL argue that the ALJ's ruling that Transco must allow shippers to contingency rank their services is unreasonable and unsupported. Transco asserts that the ALJ has not demonstrated that his proposed remedy is just and reasonable because it relies on a misunderstanding of Transco's existing and new business systems and on facts related to a unique circumstance – the unbundled retail market behind the AGL delivery points on the Transco system. Both Transco and AGL argue that the ALJ failed to recognize that Transco's tariff does not provide contingency ranking rights to shippers and that these rights are only held by delivery point operators.

Transco states that the delivery point operator is the only party responsible for identifying the service that Transco should use to account administratively for variations from scheduled amounts at the delivery point. Transco states that the allocation of deficient or excess gas at the delivery point occurs during the allocation process, i.e., after the pipeline day has ended and not as part of the scheduling process.

24. SCANA filed a brief opposing exceptions requesting that the ALJ's decision be affirmed.

**Commission Decision**

25. The Commission finds that the initial decision's holding that Transco must modify its tariff to allow replacement shippers to contingency rank Part 284 services is flawed. Transco and AGL have stated that contingency ranking rights are only available to delivery point operators on Transco's system. Even SCANA itself concedes this point when it states that section 18.1 "does not provide assurances that contingency ranking is available to shippers who are not their own delivery point operators." SCANA Initial Brief at 21. The ALJ failed to take into account the operational considerations of why contingency ranking rights are limited to delivery point operators. As Transco and AGL have pointed out, Transco transfers physical custody of gas volumes to delivery point operators at delivery points. For this reason, the delivery point operator "is responsible for confirming the flows of gas entering its system, ranking the gas that flows into its system, and contingency ranking third party gas and/or its own transportation and storage services." Ex. T-52 at 36. When there is a difference between the amount scheduled to be delivered at a particular delivery point and the amount actually delivered, the difference is simply an overall amount that, in the first instance, is attributable only to the delivery point operator. This is because the only measurement that Transco has is a measurement taken at the delivery point operator's city gate of the total deliveries taken off Transco's system and accepted onto the downstream facilities than had been scheduled to be taken. Therefore, there has to be one person with the ultimate authority to decide how to divide the overall difference between scheduled and actual deliveries among shippers and their services. This person is the delivery point operator since it controls and confirms the flows entering its downstream facilities.

26. As part of the scheduling and confirmation process, the delivery point operator will have provided Transco a ranking as to the order in which the various scheduled transactions will have been considered to have flowed through the delivery point. The higher ranked transactions will generally not be considered to have any variation between the scheduled and delivered amounts. Thus, those transactions will generally not incur any penalty or trigger a need for cashing out an imbalance, and there is no need for the customers in those transactions to seek the alternate remedy of treating those scheduling

variances as storage injections or withdrawals. Transco's witness testified that the delivery point operators generally rank third party transactions as flowing through the delivery point before their own transactions. To that extent the third party transactions are less likely to have discrepancies between scheduled and measured gas quantities, and the third parties thus have less need to contingency rank the services that will be used to account for such discrepancies, including storage services that were not actually scheduled.

27. In any event, Transco allows a delivery point operator to contingency rank "third party gas and/or its own transportation and storage services" as the services to be used in resolving differences between scheduled and actual deliveries services in the event of a discrepancy between the two. Thus, in a circumstance where an LDC delivery point operator has released no-notice service to a third party replacement shipper, the delivery point operator could designate the replacement shipper's no notice service as a service to "take the swing" and include the storage service associated with that no-notice service as a service to be used in resolving any discrepancy between scheduled and actual deliveries. The Commission assumes that the delivery point operator will consult with other shippers when making these ranking decisions. However, since delivery point operators such as AGL are not within the Commission's jurisdiction, it is not appropriate to include a direction to consult with shippers in the Transco tariff. A replacement shipper that is not a delivery point operator lacks a physical delivery point and is not responsible for confirming flows. As AGL points out, if SCANA's scheduled and measured quantities differ, neither Transco nor SCANA would be able to allocate flows after the fact to other shippers at that delivery point. In fact, the shippers to whom flows would be allocated may not be shippers on Transco's system, if the pool into which the gas flows from that delivery point allows for delivery of gas volumes from other pipeline systems. AGL BOE at 7; Ex. T-52 at 35-37. By failing to address the operational justification for limiting contingency ranking rights to delivery point operators, the ALJ has failed to show that Transco's current tariff is unjust and unreasonable.

28. Further, as Transco has pointed out, the ALJ's determination that all shippers should have contingency ranking rights is based only on facts related to a unique circumstance – the unbundled retail market behind the AGL delivery points on the Transco system. The Commission does not find that it is appropriate to make changes to Transco's tariff that would apply throughout the entire system based on evidence alleging that contingency ranking could work based on certain limited circumstances affecting only a limited geographic area on Transco's system, i.e., its interconnection with AGL. It is not even established that the SCANA's proposal, based on the use of AGL's tariff to allocate volumes, is feasible. AGL stated that the SCANA representatives have participated in workshops on the issue and have acknowledged the complexity of the

issue before the Georgia Public Service Commission. AGL states that SCANA is aware that affected parties have tried but not succeeded in developing a workable methodology that would allow implementation of their proposal. Accordingly, for these reasons, the ALJ's decision requiring Transco to modify its tariff to allow all shippers to contingency rank Part 284 services is reversed.

### C. Unbundling of Rate Schedule GSS

29. Following its restructuring consistent with Order No. 636, Transco continued to provide a number of individually certificated, bundled storage services pursuant to Part 157 of the Commission's regulations. Since that time, Transco has converted most of these services to Part 284 open access services.[14] Among other things, the Commission acted under NGA Section 5 to require Transco to unbundle the transportation and storage components of its Rate Schedule SS-1 service, and offer those unbundled services on an open access basis pursuant to Part 284.[15] In that case, the Commission found that unnecessary bundling of services such as storage and transportation is unjust and unreasonable, unless there are countervailing considerations such as that continued bundling is necessary for the pipeline to manage its system and perform no-notice transportation service. However, the Commission found that the SS-1 storage capacity was not used for such purposes, since Transco could not access the gas put in storage under Rate Schedule SS-1. This was because it neither owned the storage capacity used for that service, nor was the storage capacity directly connected to its system.

30. Transco does continue to provide bundled, Part 157 storage and transportation services in its market area, under Rate Schedules GSS and LSS. The GSS service is Transco's largest storage service and includes approximately 65 Bcf of storage capacity, and maximum daily withdrawal capability of 1,082,907 Dth per day, and a maximum daily injection quantity of 364,669 Dth per day.[16] The GSS storage facilities are located in Pennsylvania at the western end of Transco's Leidy Line. The specific storage fields that comprise the GSS service are (1) Transco's share of the Wharton storage field - 12.37 MMdth of capacity and 257,750 dth/day of deliverability, (2) Transco's share of the Leidy storage field – 15.73 MMdth of capacity and 314,568 dth/day of deliverability,

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[14] See Atlanta Gas Light Co., 102 FERC ¶ 61,323 at P40-43 (2003).

[15] Transcontinental Gas Pipe Line Corp., 87 FERC ¶ 61,087 (1999), reh'g denied, 94 FERC ¶ 61,362 (2001).

[16] Ex. No. KSD-6.

and (3) Transco's contract with Dominion for Part 157 bundled storage service – 39.04 MMdth of capacity and 620,398 dth/day of deliverability. Transco and its customers can inject or withdraw gas from GSS storage fields throughout the year and are not limited to seasonal injection or withdrawal rights. The transportation service included in the GSS service provides for transportation from the storage facilities to the GSS customers' delivery points in Zones 4 through 6 along Transco's mainline. Due to the bundled nature of the service, Transco's customers can only use the transportation component of the service in connection with injections and withdrawals of gas in the GSS storage facilities and not for any other purpose.

31. Transco's LSS service originates at interconnections with Dominion and National Fuel located within the Wharton and Leidy Storage complexes. The storage services that comprise the LSS service are (1) Transco's contract with Dominion for Part 157 bundled storage service - 10.0 MMdth of capacity and 100,000 dth/day of deliverability and (2) Transco's contract with National Fuel for Part 157 bundled storage service – 5.14 MMdth of capacity and 46,728 dth/day of deliverability. This is a seasonal storage service where withdrawals are during the winter period and injections are allowed during the summer period. Dominion allows out-of-season storage activity on a best efforts basis under its contract with Transco.

32. For both the GSS and LSS services, Transco performs a so-called "middleman role." In this role, it acts as operator for its customers of the two services, scheduling use of the services with the pipelines that operate the storage fields, based on overall system requirements, using the aggregate contract rights of its customers who contract for the services. Ex. T-13 at 6. All of Transco's Part 284, firm transportation customers receive no-notice service under Rate Schedule FT.[17] Accordingly, these customers are permitted to take any amount of gas from the system up to the aggregate daily maximum contract quantities, regardless of the amount they scheduled, without incurring daily scheduling or imbalance penalties. Transco also does not require its customers to take gas at uniform or other prescribed hourly rates during the day. Transco states that its middleman role in the operation of the GSS service enables it to offer its open access transportation customers this flexibility. When the GSS customers are not using the GSS transportation capacity, Transco uses it to transport gas from its storage facilities to the city gases, and vice versa, to accommodate the hourly and daily swings in customers demand and to restore or reduce line pack. "Since GSS service includes rights to inject and withdraw gas throughout the year, Transco's middleman use of GSS is a critical component of the

[17] Ex. T-13 at 7. Transco offers a notice transportation service under Rate Schedule FT-N, but it states that no customers have ever subscribed to that service.

collection of tools that it uses to manage its highly flexible no-notice service." Ex. T-52 at 15.

33. The Settlement in this rate case reserved for hearing two issues concerning the unbundling of Rate Schedules GSS and LSS and their conversion to Part 284 open access service. These are: (1) whether to grant PECO's request that Transco be required to provide its Rate Schedule GSS customers the option to convert their GSS storage entitlements to unbundled open access storage and transportation entitlements under Part 284 (Issue IV), and (2) whether to grant a request by South Carolina Pipeline Corporation and SCANA Energy Marketing (SCANA) for a more limited change in Rate Schedules GSS and LSS, that would permit customers to release their capacity as provided under part 284, but not give customers such other Part 284 rights such as receipt and delivery point flexibility (Issue II).

### 1. Full Conversion of Rate Schedule GSS

34. PECO argued that Transco's unwillingness to unbundle the transportation and storage components of its Rate Schedule GSS service and convert it fully to Part 284 service is unjust and unreasonable. PECO asserted that the current service it receives from Transco is unjust and unreasonable, because the service impedes competition, lacks customer flexibility, and does not allow current Part 157 customers to use the GSS transmission capacity separately from using it to withdraw gas from GSS storage. PECO alleged that the Rate Schedule GSS service violates current Commission policy concerning unbundling. PECO proposed that two separate and distinct Part 284 open access services be created – one a firm storage-only service and the other a firm transportation service that would be available not only to transport gas injected into and withdrawn from the GSS storage capacity but also for other purposes. PECO proposed that each current GSS customer electing the unbundled service would be given seasonal contract demands for firm transportation service. Thus, each current GSS customer would receive a contract demand equal to its current GSS maximum daily withdrawal quantity during the 151-day winter season and a contract demand equal to its current GSS highest maximum daily injection quantity for the remaining 214 days of the year. Dominion also asserted that Rate Schedule GSS was unjust and unreasonable and that unbundling may create additional flexibility for customers and could increase competition among service providers.

35. The ALJ held that not only was the current GSS service just and reasonable, but that the alternative proposal offered by PECO was not just and reasonable. The ALJ recognized that Transco's bundled GSS service does not give customers the same rights and flexibility they would have if the transportation and storage components were unbundled and provided pursuant to Part 284. The ALJ found, however, that these facts

are not enough to meet the Section 5 burden of showing that the current service is unjust or unreasonable. The ALJ agreed with PECO that GSS service does not permit customers to separate the transmission capacity from the storage capacity and prevents customers from choosing to use other transportation services to inject gas into storage. However, the ALJ stated that he could not agree with PECO that these limitations amount to undue discrimination.

36. The ALJ recognized that the Commission's policy is that bundling of service is unjust and unreasonable unless there are countervailing considerations. The ALJ found that countervailing circumstances exist here. The ALJ states that Transco's GSS service is necessary to maintain the key middleman role that Transco currently performs. The ALJ found that it is Transco's ability to draw on the gas placed in storage under Rate Schedule GSS and to use the associated transportation capacity to move the gas on the system that allows Transco to manage the system operations that provides the daily and hourly no-notice flexibility on which Transco's customers depend. Ex. T-52 at 12-13; Ex. T-47 at 11. The ALJ states that PECO repeatedly states that Transco has not shown why it cannot unbundle the GSS service. The ALJ stated that it was not Transco's obligation to show why, though it has, unbundling is not feasible. The ALJ found that PECO failed to show why the current service is unjust and unreasonable and failed to demonstrate that is proposed alternative is just and reasonable. The ALJ stated that PECO failed to consider the negative impacts on reliability for no-notice service on Transco's system and the related cost-allocation issues. The ALJ held that PECO had not demonstrated how Transco will have the capability to ensure the current level of service after unbundling, if it were to take place. The ALJ stated that PECO merely posits that Transco will be able to employ punitive measures like OFOs to maintain some level of control over the system and meet customer demands.

37. On exceptions, PECO asserts that the ALJ failed to grasp that PECO's proposal does not remove from Transco any significant operational aspect of its middleman role and thereby does not diminish that role's contribution to system operational flexibility and the value that flexibility offers to all customers. PECO also argues that the ALJ erred in giving credence to Transco's and the Municipal Customers' unsupported view that PECO failed to consider the impacts of its proposal on Transco's cost allocation and rate design. PECO contends that the ALJ's operational findings are inconsistent with the Commission's holdings on Transco's SS-1 unbundling. Transco, 87 FERC at 61,398. PECO asserts that bundled Part 157 GSS service deprives GSS shippers and the energy marketplace as a whole of the benefits of a fully competitive marketplace. PECO contends that the ALJ's conclusion that bundled GSS service is necessary for Transco to provide its current level of no-notice service is unsupported. PECO asserts that the record demonstrates that Transco's control over its system will remain intact under

PECO's proposal. PECO states that since its proposed conversion does not grant GSS shippers any different primary service rights other than the potential to avoid the purchase of a second transportation service to perform storage injections, Transco could rely operationally on existing tariff-based inventory and withdrawal ratchets, or the ability to restrict access to secondary points, to assure the integrity of its storage resources on critical days. PECO states that if an extremely unusual and unanticipated operational situation presented itself, Transco could issue an operational flow order or curtailment order, as it can now, to require a shipper either to source gas supplies using specific services in a manner that matches their demand for gas or to simply reduce their takes from the Transco system.

38. PECO asserts that contrary to the ALJ's finding, PECO did address the rate design and cost allocation ramifications of its proposal. PECO states that its witness testified that the unbundled Part 284 transportation service should be priced using the same zone matrix as Trasnco's Part 284 firm transportation service, with service entitlements equal to the customer's maximum daily withdrawal quantity of the associated storage contract during the 151-day winter period and equal to the maximum injection quantity of the 21 day summer injection period. PECO asserts that as for the unbundled Part 284 storage service, its witness recommended that the rate for the unbundled storage service would be the existing rate less what is currently allocated as transmission function costs.

39. Dominion also filed an exception to the initial decision, asserting that the ALJ erred in not requiring unbundling of the GSS service. Dominion asserts that while unbundling GSS service could very well decrease Transco's operational flexibility, it would increase its customers' flexibility. Dominion asserts that the assets would remain in place but the customers would just have more control over, and choice about, how the assets would be used. Dominion also asserts that Transco failed to provide credible evidence that the continued bundling of the GSS service is in fact necessary. Dominion asserts that PECO satisfied its burden of proof concerning unbundling of the GSS service.

40. In its brief opposing exceptions, Transco asserts that the ALJ correctly rejected PECO's proposal to unbundle Transco's Rate Schedule GSS service. Transco argues that it is undisputed that Transco's middleman operation of its bundled storage services, including GSS in particular, is critical to the hourly and daily flexibility that is unique to Transco's no-notice service because the storage services provide both a source of gas and capacity for moving gas on the system with which Transco can manage its overall system operations. See Ex. T-13 at 4-8; Ex. T-52 at 3-5, 11-20; Tr. 678-81. Transco contends that it is undisputed that Transco's reliance on all of its operational tools to meet its customers' demands for daily and hourly operational flexibility has increased in recent years. Tr.678-79. Transco asserts that it is undisputed that GSS is by far the largest of

Transco's bundled storage services - 65 Bcf of storage capacity, one Bcf per day of deliverability and one Bcf per day of associated pipeline capacity. Ex. T-52 at 8-9. Transco submits that it is undisputed that GSS has the most flexible terms and conditions of Transco's bundled storage services. Id. at 11-12. Transco argues that based on these facts and 25 years' experience as a pipeline engineer (including 10 years' experience in operation of the Transco system), Transco's witness, Mr. Cunningham, reasonably concluded that adopting PECO's proposal, while certainly not infeasible, would have significant adverse effects on Transco's system flexibility and, therefore, on the quality of its no-notice firm transportation service. Id., p. 13. Transco stated that Mr. Cunningham explained that if PECO's proposal was adopted, "Transco would be unable to consistently support the same level of no-notice service, i.e., hourly and daily swing flexibility that customers enjoy today. On some days Transco might not experience any difference in its capabilities, but on many other days . . . it would not be able to meet hourly and daily swing demands to the same extent that it does today." Id., p. 17. See also Ex. DPY-3, pp. 5-7, 9-10; Ex. DPY-22, p. 1.

41. Transco asserts that contrary to PECO and Dominion's claim on exceptions, the rebuttal testimony did not substantively address the rate and cost allocation issues that Transco raised. Transco states PECO is correct that its witness described how he would structure service entitlements and design rates for an unbundled GSS service. However, it overlooks the fact that the only evidence its witness offered about the implications of unbundling for establishing billing determinants and allocating costs was that such issues should be deferred until Transco's next rate case after unbundling was implemented. Ex. PE-2 at 4-5. Indeed, Transco states that PECO itself now admits that its witness proposed to address adjustments to billing determinants in the next rate case. PECO Br. at 19, n. 54 citing Ex PE-2 at 5.

42. In its brief opposing exceptions, KeySpan asserts that the Commission should either affirm the ALJ's decision to reject PECO's proposal to unbundle Rate Schedule GSS or establish further procedures to permit unbundling in a manner that will not degrade other firm services. KeySpan asserts that not only did PECO and Dominion fail to meet their burden but, to the contrary, the record establishes that Transco's need to access bundled storage for the benefit of the system is greater than ever as a result of the fact that (1) transportation customers are creating larger imbalances than ever before and (2) the expansion of Transco's customer base has created greater overall needs for hourly flexibility. Tr. 625-27, 678-79, Ex. T-13 at 5-8, Ex. DPY-1 at 25, Ex. DPY-3.

43. The Municipal Customers also filed a brief opposing exceptions supporting the ALJ's decision and asserting that neither PECO nor Dominion had met their burden of proof.

**Commission Decision**

44. The Commission has reviewed the initial decision and briefs on and opposing exceptions and will affirm the ALJ's decision that the proponents of GSS unbundling have not met their Section 5 burden of showing that the current GSS service is unjust and unreasonable and that their proposal is just and reasonable. While PECO and Dominion are correct in asserting that the Commission's policy favors unbundling of services, the Commission has allowed the continuation of bundled service when there are countervailing considerations. The Commission agrees with the ALJ's finding that such circumstances exist here. Further, while it is not Transco's burden to show that its current bundled GSS service is just and reasonable, Transco has put forth testimony explaining why it is necessary to maintain the existing bundled GSS service and why unbundling would compromise Transco's operation flexibility and its ability to perform no-notice service in the manner in which it performs such service today.

45. As discussed above, Transco has explained that unbundling the GSS transportation component would reduce the available transportation capacity that Transco could use in its middleman role, thus reducing Transco's operating flexibility. Transco stated that it would not be able to consistently support the same level of no-notice service, i.e., hourly and daily swing flexibility that customers enjoy today. Transco's witness testified that "the key to the daily and hourly operational flexibility required by customers like PECO, and provided by Transco's middleman operation of GSS and other bundled storage service, is that the storage is linked with transportation capacity on the Transco system. This enables Transco to move gas around the system as needed to meet customers' daily and hourly swing demands." T-52 at 14. Currently, GSS customers can only use the transportation component of their service when they make injections or withdrawals. When the GSS customers are not using the GSS transportation capacity, Transco uses it in its middleman role to transport gas from its storage facilities to the city gates, and vice versa, to accommodate the hourly and daily swings in its no-notice customers' demands and restore or reduce line pack.

46. By contrast, if the transportation component of the GSS service were unbundled and converted to a Part 284 open access service, the GSS customers could use the transportation service for purposes other than transporting gas injected into or withdrawn from the GSS storage facilities. Moreover, the GSS customers would have the rights to release the capacity to others and to use delivery points other than their city gates, including off-system using the various pipeline interconnections on Transco's system. Ex. T-52 at 16. As a result, Transco would likely have less access to the GSS transportation capacity to move gas around its system to support no-notice customers' hourly and daily swings, particularly during the winter when cold weather and rapid

changes in weather often lead to substantial swings in the no-notice customers' demands. Ex. T-52 at 17-18.

47. Transco stated that reduction in operating flexibility due to the unbundling and conversion of the transportation component of GSS service would require Transco to control the flow of gas into and out of its system much more tightly than it does today. Transco states that because no-notice customers take or leave gas on the system based on individual interests regardless of the consequences to the system as a whole, the unbundling proposal would require Transco to install flow controllers at many of its city gates and end use meter stations in order to protect its system and customers. Transco estimated that the cost would be several million dollars which would be recovered in rates. Transco also states that it would have to restrict or eliminate the contingency scheduling process since that is feasible only because of the operating flexibility that Transco's middleman operation of the bundled storage service provides. Transco also states that additional changes to its no-notice service would be necessary including daily scheduling and balancing penalties and revising Transco's OFO provisions to include uniform hourly take requirements. Ex. T-52 at 15-31.

48. The Commission also agrees with the ALJ that the facts that led the Commission to order the unbundling of the SS-1 rate schedule are distinguishable from the facts here. As the ALJ stated, the Commission ordered the unbundling of the SS-1 service because Transco had no control over the gas stored under the SS-1 service and therefore the bundling of transportation and storage did not add any system benefit or system flexibility to Transco's own system operation. Transco, 87 FERC ¶ 61,087 (1999), order on reh'g, 94 FERC ¶ 61,362 (2002). In the SS-1 case, the storage capacity used in connection with the SS-1 service was not owned by Transco, but was made available by North Penn Gas Co. at the Tioga storage complex in Pennsylvania. The Tioga storage complex was not directly connected to Transco's system. Rather, CNG Transmission Corp. transported storage injection and withdrawal quantities between the Tioga storage complex and Transco's system at Leidy pursuant to separate transportation agreements with the SS-1 customers. Thus, the SS-1 customers separately scheduled directly with CNG for the immediate transportation. This gave the SS-1 customers, not Transco, full control over the gas stored under SS-1 service. In this case, however, Transco is part owner of the Leidy and Wharton storage fields, and has a contract with Dominion for Part 157 bundled storage service. These facilities are directly connected to Transco's system and the gas is moved using Transco transportation capacity. As discussed above, when GSS transportation and storage capacity is not being used, Transco is able to accommodate substantial swings in customers' demand, manage excess gas on the system by making injections into storage, move gas from supply area storage to market area

storage, and minimize the effects on customers of maintenance and construction related outages of mainline facilities. Ex. T-52 at 16.

### 2. Limited Part 284 Conversion of Certain Bundled Storage Services

49. South Carolina Pipeline Corporation and SCANA Energy Marketing (SCANA) requested that the Commission direct Transco to convert service under Rate Schedules GSS and LSS from Part 157 services to a more limited Part 284 service than that sought by PECO in its unbundling proposal. Specifically, SCANA requests only that the GSS and LSS customers be permitted to engage in capacity release pursuant to the Commission's Part 284 regulations. SCANA asserts that this limited conversion would have no adverse impact on Transco because such service could not be segmented and would not have receipt and delivery point flexibility. I.D. at P 42, citing Ex. SCA-1. SCANA states that because certain changes have occurred with respect to retail gas competition in North Carolina and Georgia, a limited conversion would allow South Carolina Pipeline to release GSS capacity to certain customers converting from sales to transportation and would allow AGL to release GSS and LSS capacity to gas marketers in Georgia. SCANA argues that a limited conversion would allow other shippers and marketers to use the capacity as it is used by South Carolina Pipeline and AGL and would enhance retail competition by giving them access to competitive gas supplies.

50. The ALJ found that although the Commission favors conversion from Part 157 to Part 284 service, he cannot force such a conversion. The ALJ found that under Order Nos. 636-A and B it was clear that the Commission did not intend for Part 157 shippers to benefit from capacity release mechanisms under Part 284. The ALJ further stated that the Commission addressed the limited Part 284 conversions as proposed by SCANA in Order No. 636-B. The ALJ stated that the Commission explicitly held that "Part 157 shippers cannot simply be included in the capacity release mechanism established under Part 284." Order No. 636-B, 61 FERC ¶ 61,272 at 61,992 (1992). The ALJ held that SCANA is seeking the benefits of Part 284 service without a full conversion to that service as the Commission requires. The ALJ also found that a number of states have implemented retail unbundling without forcing a conversion of the existing Part 157 shipper to Part 284.

51. On exceptions, SCANA reiterates the arguments it made before the ALJ. It argues that the evidence in this proceeding demonstrates that Transco has not facilitated the Commission's objective to move the industry towards open access service and that anti-competitive practices continue due to the inability of replacement shippers to utilize the GSS and LSS services. SCANA asserts that its limited conversion proposal has restricted Part 284 capacity release rights, yet retains a shipper's regulatory obligations

that go along with such benefits, specifically to pay penalties. SCANA asserts that the limited conversion would have no negative impact on Transco's operations and rates. Finally, SCANA argues that the Georgia retail gas unbundling is unique and is not comparable to restructuring programs in other states.

52. Transco and AGL field briefs opposing exceptions asserting that the Commission should affirm the ALJ's decision.

**Commission Decision**

53. The Commission affirms the ALJ's finding that SCANA has not met its Section 5 burden to justify providing capacity release rights to Rate Schedule GSS and LSS customers, while in all other respects those service remain in essence Part 157 services. While SCANA asserts that it is seeking a conversion to a limited Part 284 service, its request is essentially to allow Part 157 service to have capacity release rights. Under SCANA's proposal, other elements of Part 284 open access transportation, such as segmentation and flexible point rights, would not attach to the service. The ALJ is correct in his finding that the Commission has considered and rejected in Order Nos. 636-A and B the proposition that Part 157 customers should have the ability to participate in the capacity release mechanism established under Part 284 of the Commission's regulations. SCANA has not presented any arguments in this proceeding before the ALJ or on exceptions which convinces the Commission to depart from its longstanding policy.

## **D. Incremental Rates**

### **1. Introduction**

54. In this rate case, Transco proposed to roll in the costs of the SunBelt, Pocono and Cherokee Expansion Facilities, which are currently incrementally priced, on a prospective basis, after Commission approval. Transco also proposed to roll in the costs of its Mobile Bay Expansion Project. Unlike the other three projects, the Commission granted a presumption that Transco could in its next Section 4 rate case roll in the costs of the Mobile Bay project when it certificated that project. Therefore, in this rate case, Transco proposed that the roll-in of the Mobile Bay costs take effect at the end of the suspension period, and those rolled-in rates are currently in effect.

55. When each of these four projects were certificated and put into service, the Commission's policy concerning rolled-in vs. incremental rates was set forth in its 1995 <u>Pricing Policy for New Existing Facilities Constructed by Interstate Pipelines</u> ("1995

Pricing Policy Statement").[18] However, before Transco filed this rate case, the Commission issued its 1999 Policy Statement concerning Certification of New Interstate Natural Gas Pipeline Facilities ("1999 Pricing Policy Statement"),[19] revising its policy. Accordingly, in the suspension order in this proceeding, the Commission addressed the threshold issue of which policy should be used to determine the rate treatment of the SunBelt, Pocono, Cherokee, and Mobile Bay facilities.

56. Under the 1995 Pricing Policy Statement, in deciding whether to approve rolled-in rates, the Commission sought to provide as much up-front assurance as possible of how an expansion would be priced so that the pipeline and expansion shippers could make informed investment decisions. Therefore, the Commission permitted pipelines to request in the certificate proceeding a determination of whether rolled-in rates would be appropriate in the next rate case. The Commission stated it would consider the extent to which the new facilities were integrated with the existing facilities and the specific system benefits produced by the project. When the roll-in of the costs of the new facilities caused a small rate impact (less than five percent), the proponents of roll-in only needed to make a general showing of system benefits. If the rate impact was above five percent, the proponents of rolled-in rates had to show that the benefits were proportionate to the rate impact. The 1995 Pricing Policy Statement provided that the rate design decided in the certificate order would apply to the pricing of the facilities in the first rate case after the facilities go into operation, unless the parties demonstrate that circumstances have changed significantly between the time the certificate is issued and the pipeline files the rate case.

57. Under the 1999 Pricing Policy Statement, the Commission changed the focus of its rolled-in versus incremental rate policy so that the primary goal is to achieve efficient pricing signals to expansion shippers and existing pipeline customers, while remaining within the pipeline's revenue requirement. Under this new policy, when a project is first certificated, the Commission requires that existing shippers not be required to subsidize the expansion. This generally means that expansions will be priced incrementally so that expansion shippers will have to pay the full costs of the project, without subsidy from the existing customers through rolled-in pricing. This will help ensure that the market finds the project viable, because either the expansion shippers or the pipeline must be willing to fully fund the project. However, subsequently, when a pre-expansion shipper's existing

[18] 71 FERC ¶ 61,241 (1995), reh'g denied, 75 FERC ¶ 61,105 (1996).

[19] 88 FERC ¶ 61,227 (1999), 90 FERC ¶ 61,128 (2000), reh'g, 92 FERC ¶ 61,094 (2000).

contract expires it could be required to pay a higher rate than its existing vintaged rate. This would occur where: (1) the pipeline is fully subscribed; and (2) there is a competing bid higher than the pre-expansion rate. In addition, the Commission suggested rolled-in rates could be approved before the expiration of current contracts if the facilities are needed to improve service for existing customers, the increase in rates is related to improvements in service, and raising existing customers' rates does not constitute a subsidy of an expansion by existing customers.

58. In both the March 28, 2001 suspension order[20] and a May 25, 2001 order denying rehearing of the March 28 Order,[21] the Commission stated that its current policy concerning rolled-in vs. incremental rates set forth in the 1999 Pricing Policy Statement should be applied to newly filed rolled-in rate proposals, unless the pipeline and expansion shippers had reasonably and detrimentally relied on obtaining rolled-in rates under the earlier 1995 Pricing Policy Statement in making their decisions to invest in an expansion project. After a thorough review of the circumstances surrounding the certification of each of the four projects,[22] the Commission found such detrimental reliance only in the case of the Mobile Bay project.

59. When Transco requested a certificate for the Mobile Bay project, it specifically sought an up-front determination pursuant to the 1995 Pricing Policy Statement that it could roll in the costs of the project in its next Section 4 rate case. The certificate order granted the presumption of rolled-in rates, after determining that the rate impact to existing customers from rolling in the proposed facilities was below five percent and that the pipeline had made a showing of system operational or financial benefit as required by the 1995 Pricing Policy Statement (81 FERC ¶ 61,104 and 82 FERC ¶ 61,084). The certificate order also stated that, if parties in the Section 4 rate case could show that the actual cost of the Mobile Bay project facilities was significantly higher than Transco's estimated cost and resulted in significantly higher rate impact, the parties would be permitted to challenge Transco's rate proposal when Transco filed its first rate case. Accordingly, in the suspension order in this proceeding, the Commission found that, since the purpose of the predetermination was to provide as much up-front assurance as possible of how an expansion would be priced so that the pipeline and expansion shipper could make informed investment decisions, the parties could reasonably be expected to

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[20] 94 FERC ¶ 61,360 (2001).

[21] 95 FERC ¶ 61,268 (2001).

[22] See, in particular, 95 FERC at 61,948-61,952.

have relied on the Commission's application of the 1995 Pricing Policy to any proposal by Transco to roll in the costs of the Mobile Bay project. Therefore, the Commission determined that the rate treatment of the Mobile Bay Project should be determined in this rate case based on the 1995 Pricing Policy Statement.

60. While the Sunbelt, Pocono, and Cherokee projects were, like the Mobile Bay project, certificated after the 1995 Pricing Policy Statement but before the 1999 Pricing Policy Statement, the Commission did not grant any presumption that Transco could roll in the costs of these three projects in its next Section 4 rate case. Rather, in its certificate orders,[23] the Commission required that Transco implement incremental rates for each of the three projects. In the Pocono and Cherokee certificate orders, the Commission held that those expansions must remain incrementally priced unless the proponents of rolled-in rates could show a significant change circumstances in the next rate case. In these circumstances, the Commission held in the suspension order in this case that the parties could not have relied on the Commission's approval of future rolled-in treatment for these facilities pursuant to the 1995 Pricing Policy Statement. Therefore, the Commission concluded that the rate treatment of those projects that should be determined in this case based on current Commission policy as set forth in the 1999 Pricing Policy Statement.

61. A number of parties, including existing customers of Transco, appealed the Mobile Bay Certificate orders to the United States Court of Appeals for the Fifth Circuit. The appeals challenged, among other things, the presumption for rolled-in rates. The Commission and Transco sought to have the appeals dismissed on the ground that the certificate orders made no final decision on the rolled-in rate issues, with the result that the appellants were not yet aggrieved. The Court granted the motion in Brooklyn Union Gas Company v. FERC, 190 F.3d 369 (5th Cir. 1999)(Brooklyn Union). However, the Court emphasized that all issues concerning whether Transco should be permitted to roll in the Mobile costs “remain open for contest when Transco files its rate case.” Id. at 374. The Court also stated that “petitioners must have a full opportunity to challenge the roll-in rate, including the footing of the presumption of roll-in rates itself.” Id. These issues included whether Transco may have improperly segmented projects in order to achieve a

[23] The Commission issued a certificate for the SunBelt Expansion Project on December 2, 1996 in Docket No. CP96-16 (75 FERC ¶ 61,072, 77 FERC ¶ 61,249 and 79 FERC ¶ 61,346). The Commission issued a certificate for the Pocono Expansion Project on June 26, 1997 in Docket No. CP97-328 (79 FERC ¶ 61,393). The Commission certificated the Cherokee Expansion Project on September 30, 1997 in Docket No. CP97-331 (80 FERC ¶ 61,398, 82 FERC ¶ 61,019 and 84 FERC ¶ 62,046).

rate impact of less than five percent and whether “Transco has demonstrated specific system benefits in a case in which many customers protested and the immediate benefits flow directly to WESCO, the sole shipper subscribing and a Transco affiliate, a circumstance that ought to trigger a hard look.”

### 2. Rate Treatment of the SunBelt, Pocono, and Cherokee Expansion Facilities

62. We now turn to the merits of Transco’s proposal to roll in the costs of the currently incrementally priced SunBelt, Pocono, and Cherokee expansions. The Commission issued a certificate for the SunBelt Expansion Project on December 2, 1996 in Docket No. CP96-16 (75 FERC ¶ 61,072, 77 FERC ¶ 61,249 and 79 FERC ¶ 61,346). The project involved the expansion of Transco’s mainline system from Louisiana to North Carolina and created 145,666 Mcf/d of new mainline capacity. The SunBelt expansion facilities include approximately 23,100 horsepower (hp) of new compression at five existing compressor stations in Mississippi, Alabama, Georgia, and South Carolina; approximately 15,000 hp of new compression at each of two new compressor stations in Alabama and Georgia; and approximately 15 miles of 42-inch pipeline loop on Transco's mainline between Station Nos. 140 and 145 in South Carolina. The SunBelt project increased Transco’s mainline capacity by approximately 103,500 Dth/d from Station 65 at the Louisiana-Mississippi border to Station 85, the point at which Transco’s Mobile Bay Lateral interconnects with the mainline system, and by approximately 150,765 Dth/d from Station 85 to various delivery points upstream of Station 145 at the South Carolina-North Carolina border. The SunBelt facilities went into service in November 1997.

63. The Commission issued a certificate for the Pocono Expansion Project on June 26, 1997 in Docket No. CP97-328 (79 FERC ¶ 61,393). The Pocono project consists of the installation of 4.88 miles of 36-inch pipeline loop on Transco’s Leidy Line in Lycoming County, Pennsylvania. This pipeline loop provides capacity for an additional 35,000 Dth/d of firm service from the Leidy market hub. The Pocono facilities also went into service in November 1997.

64. The Commission certificated the Cherokee Expansion Project on September 30, 1997 in Docket No. CP97-331 (80 FERC ¶ 61,398, 82 FERC ¶ 61,019 and 84 FERC ¶ 62,046). The Cherokee expansion project generally consists of: installing approximately 11 miles of 48-inch loop pipeline on Transco’s mainline in Alabama; installing a gas cooler at Station No. 110 in Alabama; upgrading the maximum allowable operating pressure of certain segments of 16-inch pipe in Georgia; adding approximately 15,000 hp of compression at a new Station No. 115 in Georgia; adding approximately 8,000 hp of compression at Station No. 125 in Georgia and making various modifications

to existing compressor units at the existing Station Nos. 110 and 120 in Alabama and Georgia, respectively; and modifying certain metering and pig launching/receiving facilities in Georgia. The Cherokee expansion added approximately 87,070 Dth/d of firm capacity to Transco's mainline system in the southern market area of Alabama and Georgia. The Cherokee facilities went into service in November 1998.

65. Each project was fully subscribed under long-term, firm service agreements at the time of construction and is so today. Ex. T-40 at 6.

**The ALJ's Decision**

66. Despite the holding in the suspension order that the 1999 Pricing Policy should govern the decision whether to roll in the costs of these projects, Transco argued at the hearing that the 1995 Pricing Policy should apply because the projects were consistent with that policy. The ALJ found that the Commission, in its suspension order, expressly held that the 1999 Pricing Policy should govern Transco's proposal. The ALJ concluded that he was not only bound by the Commission's order to apply the 1999 Pricing Policy Statement to this case, but that he could find no reason to disagree with the Commission's conclusions in the suspension order setting the case for hearing.

67. With respect to the Cherokee and Pocono expansion facilities, the ALJ found that rolled-in rates were unjust and unreasonable. The ALJ found that in order for rolled-in rates to apply to the Cherokee and Pocono facilities, changed circumstances must be shown. The ALJ stated that this required more than a showing by Transco that it is prepared to financially support the projects without subsidies from existing customers. The ALJ stated that he was persuaded by the data offered by the opposing parties demonstrating that the revenue responsibility will increase after a roll-in of Cherokee and Pocono. Ex. S-64 and Ex. CE-25. The ALJ found that under the 1999 Pricing Policy, such an increased revenue responsibility impedes any proposal for rolled-in cost treatment. The ALJ found that Transco has neither demonstrated a system benefit that would justify a shift from incremental rate treatment to rolled-in costs, nor has it demonstrated that circumstances have changed so that rolled-in rates would be justified.

68. With respect to the SunBelt expansion, the ALJ found that the current rate structure – incremental rates – is just and reasonable and should not be replaced with rolled-in rate treatment. The ALJ found that Transco demonstrated a change in circumstance in that overall rates will decrease if the SunBelt project is rolled-in for particular rate zones on Transco. The ALJ stated that, however, as identified by Staff and ConEd/Philadelphia Gas Works, the rate after roll-in will actually increase in many of the zones. The ALJ determined that the opportunity to lower rates in one zone while increasing costs allocated to other zones under the same project was an inconsistent

application of the Commission’s policy. Further, the ALJ referred to the suspension order in this proceeding where the Commission stated that it would not be unduly discriminatory to delay full roll-in until the contracts between Transco and its current shippers expire. Transco, 94 FERC at 62,303. The ALJ concluded that incremental rates will remain until the existing contracts expire, and at that time, Transco will be permitted to file for rolled-in rates for the SunBelt expansion project.

**Exceptions**

69. On exceptions, Transco argues that it was arbitrary and capricious to apply the 1999 Pricing Policy Statement to these projects and the 1995 Policy Statement should apply. Transco claims that it had a reasonable expectation that the 1995 Policy Statement would apply in determining whether the rates should be rolled-in or incremental. Transco asserts that it is unlawful to retroactively apply the 1999 Pricing Policy Statement to these projects since the 1995 Policy Statement was the prevailing policy when these projects were certificated. Transco contends that, under the 1995 Policy Statement, rolled-in rates are justified because the rate impact on existing customers is less than five percent and the projects produce system benefits. Transco further argues that even if the 1999 Pricing Policy Statement applies rolled in rates are justified because the projects do not depend on subsidies from non-expansion shippers and are economically self sustaining as fully subscribed incrementally priced facilities even without roll-in. Specifically, with respect to the SunBelt project, Transco argues that the ALJ erred by denying rolled-in treatment based on an examination of the rate impact on a zone by zone basis. Transco argues that the analysis should have been based on the impact on each firm rate schedule rather than each zone.

70. A number of parties filed briefs opposing exceptions supporting the ALJ’s decision.

**Commission Decision**

71. As the ALJ determined, the Commission in the suspension order in this proceeding, and on rehearing of that order, expressly held that the 1999 Pricing Policy Statement should govern Transco’s proposals. As stated in the suspension order, whether the 1995 Pricing Policy or the 1999 Pricing Policy applied to Transco’s proposal was a threshold issue to be decided in order to facilitate the hearing. Transco, 94 FERC at 62,301. Since that threshold issue was addressed by the Commission in its two orders, it was not an issue to be raised in the hearing. Moreover, the issues raised by Transco on exceptions with respect to which Pricing Policy applies were fully addressed by the Commission on rehearing of the suspension order in this proceeding. Transco, 95 FERC

¶ 61,268 at 61,950-61,952. Accordingly, the Commission finds that the ALJ was correct in applying the 1999 Pricing Policy to the Cherokee, Pocono and SunBelt expansions.

72. The Commission affirms the ALJ's finding that rolled-in rate treatment for the Cherokee and Pocono Expansion is not appropriate and that they should remain incrementally priced. The ALJ was correct in finding that rolling in the costs of the Cherokee and Pocono expansion would increase the revenue responsibility of existing shippers and that such increase would be inconsistent with the 1999 Pricing Policy Statement because it would mean that non-expansion shippers would financially subsidize expansion shippers. The Staff's analysis shows that rolling in the costs of the Cherokee expansion would produce an overall average system transportation rate increase of 1.710 percent under one study and 1.458 percent under another study. Ex. S-64. With respect to the Pocono facilities, Staff's analysis shows an overall average system transportation rate increase of 0.152 percent under one study and 0.118 percent under another study. Ex. S-64. Transco's own studies also show that roll-in of the Pocono and Cherokee facilities would result in rate increases. Ex. CE-25 at 5-7 and 11-13.

73. Given those rate increases, allowing Transco to roll in the costs of these two projects would be inconsistent with the 1999 Pricing Policy Statement. This is because roll-in would require existing shippers to subsidize the projects during the terms of their current contracts. In its February 9, 2000 Order clarifying the 1999 Pricing Policy Statement, the Commission stated that the requirement that pipeline expansions should not be subsidized by existing customers is necessary to enable a finding of market need for the project. The Commission stated that the removal of the subsidy is necessary to ensure that the market finds the project viable because either the pipeline or its expansion customers are willing to fully fund the project. 90 FERC ¶ 61,128 at 61,392 (2000). The Commission also stated that one of its goals is to protect captive customers from rate increases, during the terms of their contracts, that are unrelated to the costs associated with their service. The Commission stated that raising the rates of existing shippers during the term of their long-term contracts in order to subsidize expansions for new shippers reduces rate certainty and increases contractual risk. Id. at 61,393. Transco contends that the goal of ensuring that the market finds a project viable has already been met since the expansion shippers signed up for the projects under incremental rates. Therefore, it argues, rolled-in rates can be allowed for these projects without violating the 1999 Pricing Policy Statement. However, the Commission's goal of no subsidies by existing shippers for expansion projects would be undercut if a pipeline could simply sign shippers up for an expansion project under incremental rates and then turn around and propose rolled-in rates before the end of the existing customers' contracts. Expansion shippers could anticipate a relatively quick roll-in and thus not expect to fully fund the

project. Transco's argument also fails to take into consideration the policy of protecting existing customers from expansion-related rate increases during the term of their contracts.

74. With respect to the SunBelt expansion, the ALJ acknowledges that roll-in would produce an overall rate decrease. Under Staff's analysis, the SunBelt roll-in will produce an overall average system transportation rate decrease of 0.018 percent under one study and a 0.0024 percent rate decrease under another study. Ex. S-64. The ALJ finds, however, that incremental rates for SunBelt should remain because the rate after roll-in will increase in many of the zones. Staff's analysis of the SunBelt project shows that on a more detailed rate zone by rate zone basis rate increases as well as decreases were shown in the various zones. For example, under one study the percent rate change by zone ranged from a decrease of 2.2 percent to an increase of 1.4 percent. Under another study the percent change by rate zone ranged from a decrease of 2.1 percent to an increase of 1.1 percent. The Commission agrees with the ALJ's finding that incremental rates should remain because, while it is true that there may be an overall system rate decrease, it would be inconsistent with the 1999 Pricing Policy to have non-expansion shippers in certain zones experience a rate increase and, therefore, financially subsidize expansion shippers through rolled-in rates.

75. The Commission has also stated that existing customers' rates can be increased for projects that improve their service and 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 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. Id. at 61,393. However, there must be a specific benefit from the project for existing shippers rather than generalized benefits resulting from the project being integrated into the system. Here, Transco has not made any effort to show any real improvement in the existing customers' services, such as the need for fewer OFOs, better access to competitive gas supplies, etc. The Commission accordingly concludes that Transco has not met its Section 4 burden to show that roll-in of the Cherokee, Pocono and SunBelt projects is just and reasonable.

76. Finally, the Commission's decision here does not mean that expansions must always be priced incrementally. Transco has the opportunity to increase rates to existing customers when their contracts expire. The Commission has stated that when an existing customer's contract expires, the existing customer should be treated similarly to new customers for pipeline capacity, who face rates higher than the pre-expansion historic rate. In its February 9, 2000 order clarifying the 1999 Pricing Policy Statement, the

Commission stated that a shipper exercising its ROFR could be required to match a bid up to a maximum rate higher than the historic maximum rate applicable to its capacity in certain limited circumstances: when a pipeline expansion has been completed and an incremental rate exists on the system; the pipeline is fully subscribed; and there is a competing bid above the maximum pre-expansion rate applicable to existing shippers. To adjust the maximum rate applicable to shippers exercising their ROFR in these circumstances, the pipeline would have to establish a mechanism for reallocating costs between the historic and incremental rates so all rates remain within the pipeline's cost of service. The mechanism can be established either through a general Section 4 rate case or through the filing of pro forma tariff sheets which would provide the Commission and the parties with the opportunity to review the proposal prior to implementation. The Commission would review the proposed mechanism to determine how well it achieves the following objectives: capacity pricing that permits as efficient an allocation of capacity as is possible under cost-of-service ratemaking; protection against the exercise of market power by the pipeline (through withholding of capacity or the potential for skewed bidding); protection against the pipeline's over-recovery of its revenue requirement; and equity of treatment between shippers with expiring contracts and new shippers to the system seeking comparable service. 90 FERC ¶ 61,128 at 61,394-5 (2000); Order No. 637 at 31,338-9; Order No. 637-A at 61,635-9.

### 3. <u>Rate Treatment of the Mobile Bay Expansion Project</u>

77. The Commission certificated the Mobile Bay Expansion Project on January 30, 1998 in Docket No. CP97-92 (81 FERC ¶ 61,104 and 82 FERC ¶ 61,084). The project involved the construction of supply area facilities from Compressor Station 82 in Alabama extending offshore. In addition to the pipeline, the expansion included the addition of a 15,000 hp compressor at Compressor Station 82 and a 15,000 hp compressor at new Compressor Station 83. The expansion facilities comprise a proposed new rate zone, Zone 4B. The project had a projected cost of approximately $120.2 million.

78. In its certificate application, Transco proposed to render the new transportation service under its Rate Schedule FT and Part 284 of the Commission's regulations. Once approved and constructed, the project facilities would initially become part of Transco's Rate Zone 4A, and Transco would charge the Rate Schedule FT maximum rate for Zone 4A as an initial rate for the entire project capacity as soon as Phase I service commenced. Transco stated that it intended to file, in its first rate case following the in-service date of Phase II of the project, tariff sheets to roll in the costs of the project facilities and create a new Zone 4B, which would include all of the new facilities upstream of existing Station

No. 82. Pursuant to the 1995 Pricing Policy Statement, Transco requested that the Commission grant a preliminary determination for rolled-in rate treatment.

79. The Commission granted the request. The Commission found that the rate impact caused by Transco's proposed rolled-in treatment was below the five percent threshold for all rate zones.

80. In the preliminary determination on the Mobile Bay Project, the Commission found that the rate impact caused by Transco's proposed rolled-in treatment was below the five percent threshold for all rate zones. The Commission computed the net FT demand rate impact for Rate Zone 4A shippers to be approximately 4.79 percent after the creation of a new rate zone (Zone 4B). The Commission found that the 100 percent load factor Zone 4A FT rate was approximately 4.98 percent higher than the existing rate, and the effect on the other zones is considerably less, between approximately 2 and 3 percent. The Commission also found that Transco provided evidence of system benefits by the new facilities. The Commission found that the proposed facilities would be used to effectuate deliveries to customers at Station No. 85 and throughout Transco's system, increasing the access of Transco's system customers to gas supply sources in the Mobile Bay area. The Commission concluded that, unless circumstances materially change between the date of issuance of the order and Transco's filing of its first general rate proceeding after all facilities are placed in service, Transco may roll in the costs of the proposed facilities in such rate case. Transco, 81 FERC ¶ 61,104 at 61,383-61,384.

81. The actual construction cost was $154.2 million. The Mobile Bay Expansion Project was placed in service, in part, in August 1998 (Phase I) and in total in November 1998 (Phase II). The project has a capacity of 350,000 Mcf/d, though the project also reflects the relinquishment of 86,152 Mcf/d of capacity on the original Mobile Bay facilities which comprise Transco's Zone 4A. The only shipper to sign a long-term contract for capacity from the expansion project was Transco's marketing affiliate, Williams Energy Services Company (WESCO), who contracted for all 350,000 Mcf/d of the capacity. WESCO subsequently assigned the capacity to another Transco Marketing affiliate, Transco Energy Marketing Company (TEMCO).

**The ALJ's Decision**

82. The ALJ rejected Transco's proposal to roll in the Mobile Bay costs in this rate case. Consistent with the Commission's holding that the 1995 Pricing Policy should govern the determination whether the Mobile Bay costs should be rolled in, the ALJ stated that he would apply a presumption in favor of rolled-in rates. However, the ALJ stated that this does not terminate Transco's obligation to show system benefits in order to obtain rolled-in treatment. The ALJ determined that the 1995 Pricing Policy states that

the Commission will apply the presumption when the rate increase to existing customers is five percent or less and when the pipeline makes a showing of system benefits. The ALJ found that since the current proceeding is the first since the certificate order and Transco is seeking rolled-in rate treatment, such a proceeding is brought under Section 4 of the NGA and Transco bears the burden of showing that such system benefits exist. The ALJ stated that upon making such a showing, the burden then shifts, under the 1995 Pricing Policy, to those opposing the roll-in to show that circumstances have significantly changed since the certification of the project in order to rebut the presumption for rolled-in rates.

83. The ALJ then found that there were several distinct areas where circumstances have notably changed. The ALJ held that the first circumstance that rises to the level of changed circumstances is that TEMCO, an affiliate of Transco, is the only shipper currently subscribed to Mobile Bay Expansion Project. The ALJ pointed out that in Brooklyn Union the Court found that this affiliate relationship should "trigger a hard look. . . . WESCO [TEMCO's predecessor] and companies like Destin are competitors, and WESCO will enjoy large advantages if rolled-in rates are allowed. Providing the roll-in subsidy allows WESCO to receive 100 percent of the transportation capacity while paying only 41 percent of the cost of service, $10.0 million. Transco's unaffiliated ratepayers will suffer an initial annual cost shift of $15.7 million."[24] The ALJ stated that the Court's explicit highlighting of this affiliate transaction as one that needs close examination is a change in circumstance since the certificate was issued. The ALJ also found that, while Transco had held an open season for the Mobile Bay expansion, in which non-affiliates could have bid for the capacity, the sole producer at the Mobile Bay receipt point had dedicated significant amounts of its production to WESCO. As a result, it was unlikely that any other shipper would have been able to gain access to the Mobile Bay expansion. The ALJ stated that, while the Commission was aware that WESCO was a Transco affiliate when it certificated the Mobile Bay project, the dedication of most supplies to WESCO had not been clear from the record in the certificate proceeding. The ALJ concluded that the fact a Transco affiliate would benefit 100 percent from an expansion for which it would shoulder only 41 percent of the cost is an unreasonable subsidization by existing customers and an undue preference between these corporate affiliates.

84. With respect to system benefits, the ALJ stated that while Transco has created the opportunity for benefits to accrue to the entire system those benefits are largely not realized today. The ALJ pointed out that average use of the Mobile Bay facilities over a

[24] Brooklyn Union, 190 F.3d at 369.

37 month period was only 46.3 percent of total capacity created by the expansion. The ALJ determined that the benefits are insufficient to permit rolling in the costs of the Mobile Bay Project at the level proposed by Transco.

85. The ALJ found that, for purposes of determining rate impact, the Mobile Bay and Cherokee Projects should be grouped into one project, thus yielding one calculation to determine the revenue responsibility for existing customers. The ALJ found that the record evidence shows that the Mobile Bay and Cherokee Projects are similarly situated in regard to timing and location. The ALJ stated that the certificate applications were sought less than one month apart and the open season was separated by just two days. The ALJ stated that the Mobile Bay delivery point and the Cherokee receipt point are both located at Station 85. The ALJ also found that the parties treated the projects as related. For example, the ALJ states that the record supports the fact that when Transco sought internal approval to build Mobile Bay it referred to the relationship between Mobile Bay and Cherokee. The ALJ determined that all of these factors led him to conclude that these projects should be considered together as part of the Transco Mobile Bay investment strategy for purposes of evaluating the 1995 Policy's five percent impact test.

86. The ALJ found that the revenue responsibility of rolling-in the Mobile Bay and Cherokee facilities exceeds the maximum five percent that the 1995 Pricing Policy sets. Specifically, the ALJ accepted ConEd and Philadelphia Gas Work's evidence that the impact on rates for existing customers is a 5.62 percent increase in FT reservation charge revenue responsibility and a 5.43 percent increase in the total revenue responsibility of FT shippers. The ALJ went on to state that his analysis of the affiliated relationship and the system benefits led him to conclude that even if the five percent threshold is not exceeded by combining Mobile Bay and Cherokee, though the evidence supports that it does, existing shippers opposed to roll-in have persuasively demonstrated that the system benefits do not warrant even this rate increase. The ALJ concluded that Transco's proposal for rolling in the costs of the Mobile Bay project was unjust and unreasonable and that the preponderance of the evidence favors a finding of incremental pricing for Mobile Bay.

**Exceptions**

87. On exceptions Transco asserts the ALJ's adoption of proposals to require incremental rates for the Mobile Bay Expansion Project is unsupported by the record. Transco states that, in its direct testimony, it showed that rolling in the costs of the Mobile Bay Expansion project would increase the revenue responsibility of Rate Schedule FT transportation customers by 3.01-3.75 percent. Ex. T-48 at 7-8. Transco states that it later produced calculations, based on the April 2002 settlement, showing that

rolled-in rate treatment would increase the FT revenue responsibility by 3.89 percent. Ex. CE-25 at col. E. line 3.

88. With respect to the burden of proof, Transco states that unless they have rebutted the presumption favoring roll-in treatment with a showing of significantly changed circumstances, the advocates of incremental pricing of the Mobile Bay Expansion can only prevail if they otherwise satisfy the dual burden of proof under Section 5 of the NGA. Transco states that the ALJ's error concerning how to apply the presumption directly led to the initial decision's unjustifiable ruling that Transco bore an initial burden of showing the existence of system benefits and that such a showing is a prerequisite to imposing on the opponents of rolled-in rates a duty to show significantly changed circumstances. Transco asserts that the 1995 Pricing Policy requires the showing of system benefits only as a prerequisite to the presumption in favor of rolled-in pricing in the certificate proceeding. 1995 Pricing Policy at 61,916. Transco argues that the ALJ's error regarding burden of proof is otherwise masked by the decision's purported findings that the opponents of rolled-in rates did in fact demonstrate changed circumstances that rebut the presumption in favor of rolled-in rates. Transco contends that those findings are themselves unsupported by the record.

89. Transco asserts that the ALJ's finding that Transco's contractual relationship with its affiliate is a changed circumstance is incorrect. Transco's affiliate, TEMCO, is the sole shipper on the Mobile Bay Expansion subscribing to the full 350 MMcf/day capacity of the project. Transco states that the decision finds that the affiliate relationship is a significantly changed circumstance since the expansion was authorized. Transco argues that this is incorrect. Transco argues that the initial decision unjustifiably discounts the undisputed fact that, when Transco announced the open season for the Mobile Bay Expansion on November 15, 1996, it stated unequivocally that it proposed to roll in the costs of the expansion. Ex. T-62. Transco states that any shipper, whether affiliated with Transco or not, could have taken advantage of Transco's announcement that intended to propose rolled-in rates for this expansion. Transco states that the Commission itself noted that Transco offered rolled-in rates to all prospective expansion customers and, therefore, has rejected contentions that rolled-in rate for the Mobile Bay Expansion create an unfair advantage for Transco's affiliate. Transcontinental Gas Pipe Line Corp., 82 FERC 61,084 at 61,317-19 (1998).

90. Transco states that the initial decision is wrong in stating that, in the certificate proceeding, the Commission did not have a complete record concerning the relationship

between SOCO Offshore[25] and WESCO and the fact significant amounts of SOCO's production was dedicated to WESCO at the Mobile Bay (MBX) receipt point. I.D. at P 111. Transco argues that the Commission did know about Transco's contract with its affiliate when it issued the Mobile Bay Expansion certificate. Transco states that the January 1998 Order specifically refers to WESCO's commitment to contract for all of the expansion capacity. Transcontinental Gas Pipe Line Corp., 82 FERC at 61,316 (1998). Transco contests the ALJ's finding that SOCO was the sole producer at the MBX receipt point in Block 261 and that WESCO's allegedly exclusive agreement for the SOCO supply meant no other shippers could bid on the MBX capacity during Transco's open season. I.D. at P 110-111. Transco states that the initial decision cites no evidence whatsoever for the proposition that SOCO was the only producer that had gas available at the expansion's receipt point.

91. Transco asserts that the record established that the production SOCO committed to its contract with WESCO was from SOCO's interests in 11 different offshore blocks, including East Main Pass Block 261, where the Mobile Bay Expansion originates. Ex. BP-9 at 2. Transco contends that the initial decision offers no reason why other producers in East Main 261 or in any of the other 10 offshore blocks where SOCO produces its gas could not have likewise made arrangements to deliver gas to the Mobile Bay receipt point. Transco asserts that other evidence shows that at least one other producer, BP Energy, discussed with Transco the prospect of taking service on the Mobile Bay Expansion, and that other producers in fact later arranged to deliver gas to Transco's Mobile Bay Expansion facilities from other offshore areas. Ex. BP-1 at 2-3; Ex. BP-10 at 2. Transco asserts that it was clear error for the initial decision (a) to discount the undisputed evidence that Transco offered rolled-in rates to all potential shippers on the Mobile Bay Expansion, and (b) to disregard the Commission's previous holding that, because Transco offered rolled-in rates to all potential shippers in a non-discriminatory open season, the company's contract with its affiliate does not create a disparate pricing scheme for similarly situated shippers. Transcontinental Gas Pipe Line Corp., 82 FERC ¶ 61,084 at 61,319 (1998).

92. Transco asserts that the initial decision's evaluation that the Mobile Bay Expansion has not produced system benefits is flawed. Transco states that utilizing its

[25] SOCO Offshore, an affiliate of Snyder Oil Corporation, is a natural gas producer that signed a life-of-reserves agreement for Williams Energy Filed Services to gather and process SOCO's natural gas production from 11 offshore blocks in the eastern Gulf of Mexico. The gas will be transported on the Transco system. WESCO, a unit of Williams Energy Merchant Services, will purchase and market the associated volumes.

erroneous view in this case of the presumption in favor of rolled-in rates, the initial decision asserts that the 1995 Pricing Policy requires Transco to identify the system benefits of the Mobile Bay Project and how the project will create those benefits. Transco argues that the initial decision fails to recognize that the opponents of rolled-in failed to demonstrate any changed circumstances with respect to system benefits. Transco argues that while the ALJ asserts that system benefits are insufficient to permit roll-in, the initial decision never explains what threshold of benefits the ALJ applied or from where he derived it. Transco states that, as the Commission concluded, the principal benefit of the Mobile Bay Expansion that justifies rolled-in treatment is the additional access to gas supplies, i.e., to more competing alternative supplies, that the expansion provides to all Transco shippers. Transco states that the Commission imposed no conditions regarding the level of throughput that it expected the Mobile Bay Expansion to achieve by the time of the first rate case (or at any particular time thereafter).

93. Transco states that, as the initial decision points out, Transco's opponents contended that 50 percent load factor utilization of the Mobile Bay Expansion and the availability of large amounts of unsubscribed capacity on the Destin Pipeline and Dauphin Island Gathering System constitutes significantly changed circumstances. Transco states that the first argument is premised on the idea that the Commission anticipated a particular level of use at the time of Transco's first rate case after placing the project in service. Transco asserts that nothing in the Commission's orders suggests any such expectation on its part, however. Transco argues that the gas supply benefit of the Mobile Bay Expansion is demonstrated both by the actual gas transported on the project and by the access to additional supplies that it provides. Ex. T-47 at 26. Transco states that the other benefits of the Mobile Bay Expansion underscore the fallacy of the opponents' argument, however, based on utilization of the facilities. Ex. T-47 at 24-26; Ex. T-48 at 15.

94. Transco contends that the initial decision fails to justify treating the Mobile Bay Expansion and Transco's Cherokee Expansion as a single project for purposes of applying the 1995 Pricing Policy. Transco states that the proper inquiry under the 1995 Pricing Policy's prohibition against segmenting is whether Transco created two projects in order to circumvent the five percent rate impact test. Transco states that not only does the initial decision fail to even mention this question, but it also overlooks the fact that the Commission already has considered and decided the issue. Transco states that when the Commission authorized the Mobile Bay Expansion, it concluded that there was no evidence that Transco segmented the Mobile Bay and Cherokee projects to avoid the five percent rate impact threshold, and, therefore, that only the costs of the Mobile Bay Expansion are properly included in the analysis of the rate impact of rolling in the mobile

Bay costs. Transco, 82 FERC at 61,313-14. Transco contends that the ALJ identifies no new evidence, much less significantly changed circumstances, to justify disregard of the Commission's previous findings.

95. Staff also filed a brief on exceptions asserting that the ALJ erred in ruling that Transco's Mobile Bay Expansion Project should be priced incrementally and not be rolled into Transco's system transportation rates.

96. A number of parties field briefs opposing exceptions asserting that the ALJ's decision requiring incremental rates for the Mobile Bay Project was correct.

**Commission Decision**

97. The Commission reverses the ALJ's holding that Transco's proposal for rolled-in rates should be rejected and Transco should be required to implement incremental rates. For the reasons discussed below, the Commission finds that Transco has satisfied its burden under NGA Section 4 to show that its proposed rolled-in rates are just and reasonable, and accordingly its proposal is accepted.

98. As discussed above, the Commission determined in the suspension order in this proceeding that the issue whether to roll in the costs of the Mobile Bay expansion should be decided pursuant to the 1995 Pricing Policy Statement. When Mobile Bay was certificated, the Commission made a predetermination that, absent changed circumstances, Transco would be permitted to roll in the Mobile Bay expansion costs in its next Section 4 rate case. Ordinarily, under the 1995 Pricing Policy Statement, such a predetermination in the certificate proceeding would create a presumption for rolled-in rates in the Section 4 rate case, and the parties opposing rolled-in treatment would be required to rebut that presumption by showing significantly changed circumstances since the certificate was issued. However, in this case, the Commission's certificate orders granting the predetermination for rolled-in rates were appealed to Court. The Commission and Transco sought to have the appeals dismissed on the ground that the certificate orders made no final decision on the rolled-in rate issues, with the result that the appellants were not yet aggrieved. The Court granted the motion, but emphasized that, as a result, all issues concerning the roll-in of the Mobile costs "remain open for contest when Transco files its rate case . . . . including the footing of the presumption of roll-in rates itself." Brooklyn Union, 190 F.3d at 374.

99. In these circumstances, the Commission has reviewed the evidence as if there had been no predetermination in the certificate proceeding and the Commission was addressing the roll-in issue under the 1995 Pricing Policy Statement for the first time in this Section 4 rate proceeding. The Commission has thus used the same standards and

type of analysis as was used to decide the rolled-in rate issues in Transco's last Section 4 rate case, where the Commission applied the 1995 Pricing Policy Statement to various expansions for which there had been no predetermination on the rolled-in vs. incremental rate issue in the certificate proceedings. See Transco, 87 FERC ¶ 61,087 (1999), reh'g denied, 94 FERC ¶ 61,362 (2001). Based on this analysis, the Commission finds that Transco has supported the roll-in of the Mobile Bay costs, even without the benefit of any presumption arising from a predetermination in the certificate proceeding.

100. Before this rate case, Transco charged its Zone 4A rate for service on the Mobile Bay expansion. Transco's proposed rolled-in rates thus represent a change from the existing Mobile Bay rate, and Transco bears the burden under NGA Section 4 to show that its proposed rate is just and reasonable. By the same token, however, the proponents of incremental rates are also seeking a change from the existing Mobile Bay rate. [26] In order to adopt incremental rates in this case, the Commission would therefore have to make three findings: "first, it must conclude that under Section 4 the pipeline failed to carry its burden of proof that the proposed [rolled-in] rate was just and reasonable; second, it must itself demonstrate that the default position, the prior rate, is no longer just and reasonable; and third, it must establish that its substitute [incremental] rate is just and reasonable." Id at 1579. Because we find that Transco did satisfy its Section 4 burden, we do not reach the issue whether an incremental rate might also be just and reasonable.

101. As we discussed in our orders on the rolled-in rate proposals in Transco's last rate case, under the 1995 Pricing Policy Statement[27] a rolled-in rate proposal having a rate impact of less than five percent is entitled to a presumption in favor of rolling in the costs if the pipeline makes a general showing of benefits. Correspondingly, where a proposal is shown to have a significant rate impact, defined as greater than five percent, the proponent must show that the benefits are proportionate to the rate impact. Since the nature of the benefits which must be shown to justify rolled-in rates turns on the rate impact, we first consider the rate impact issue.

102. The ALJ found that, in order to determine rate impact, the Mobile Bay expansion should be grouped with the Cherokee, since the two projects were so interrelated they should be treated as a single overall project. He then found that the rate impact of rolling

[26] Western Resources, Inc. v. FERC, 9 F.3d 1568, 1578-80 (D.C. Cir. 1993) (The Commission bears the burden under Section 5 whenever it moves beyond rejection of a proposed rate to the task of redesigning it.)

[27] 87 FERC at 61,388.

in the costs of both projects would be slightly more than five percent. However, in the preceeding section, the Commission has rejected Transco's proposal to roll in the costs of the Cherokee project. Since the Cherokee project will continue to be incrementally priced, there is no reason to include its costs in a determination of the rate impact of rolling in the Mobile Bay costs. The Commission accordingly finds that the rate impact issue must be resolved by calculating the impact of rolling in the only costs that will be rolled in -- costs of the Mobile Bay project alone. In its brief on exceptions, Staff states that the two alternative rate studies it performed confirm that the system rate impact of rolling in the actual costs of the Mobile Bay project is below five percent and, indeed, below the estimated 4.79 percent rate impact to Zone 4A FT shippers found by the Commission to warrant a preliminary determination of rolled in treatment for the Mobile Bay Expansion. In the two studies, Staff calculated the rate impact based on the cost of service in the April 12, 2002 uncontested settlement with certain adjustments. The first study determined that the impact of rolling in the cost of Mobile Bay is 4.609 percent. The second study, which reflected the roll in of certain Leidy Line and Southern expansion projects was 3.70 percent. Staff B.O.E. at 10-13; Exs. S-64 and 65. [28] As Staff has stated, "no one in this proceeding seriously challenges the outcome of Staff's analysis that the roll-in of the Mobile Bay costs causes less than a 5 percent impact on system rates. The only way the 5 percent test is exceeded is if the costs of the Mobile Bay project are combined with the costs of the Cherokee project." Staff B.O.E. at 15. Accordingly, we conclude that the rate impact of rolling in the Mobile Bay costs is less than five percent.

103. In light of the less than five percent rate impact, the 1995 Pricing Policy Statement requires Transco only to make a general showing of benefits from the expansion in order to justify its Section 4 roll-in proposal. Transco has presented sufficient evidence of benefits to meet this standard. The primary benefit of the Mobile Bay Project is that it affords increased access to different sources of gas supply in the Mobile Bay region where the development of resources continues to expand and the project is fully integrated with the rest of Transco's system. As Transco points out, "these facilities extend into the Gulf of Mexico and add compression at Stations 82 and 83, all to expand the capacity and capabilities of the pipeline to enhance supply to the Transco system as a whole." Ex. T-47 at 25; see also Ex. T-48 at 3-4.

[28] The Commission need not address the ALJ's finding that it was inappropriate to include the costs of the Leidy Line and Southern Expansion facilities in calculating the rate impact of rolling in the Mobile Bay Project since the studies excluding those facilities show that the rate impact is less than 5 percent.

104. The ALJ found that these benefits were inadequate to support roll-in of a project, where the rate impact was greater than five percent, since the average use of the Mobile Bay facilities over a 37-month period was 46.3 percent of the total capacity and the Destin and Dauphin Pipelines provided more gas supply to the Transco mainline than the Mobile Bay project. I.D. at P 115. However, the fact remains that the Mobile Bay project does provide access to additional supplies. As Transco has shown, a number of new fields (East Main Pass Blocks 259, 261 and 264; Viosca Knoll Block 739; Mississippi Canyon Blocks 305, 348, 772 and 773; and Desoto Canyon Block 133) have been or will be attached upstream as a result of the expansion. Ex. T-47 at 26. Further, the ability of the supply to access Transco's mainline downstream of Station 85 adds to system-wide reliability when there are supply emergencies, or capacity or other difficulties, such as compression or pipeline outages upstream in Transco's traditional production area. Id. Given that we have found the rate impact is less than five percent, we find that these benefits are adequate to support a finding that rolled-in rates are just and reasonable.

105. The ALJ was also concerned about the affiliate relationship between Transco and TEMCO. The ALJ found that because SOCO was the sole producer at the Mobile Bay receipt point and it had dedicated its reserves to WESCO, it was unlikely that any other shipper would have subscribed to the Mobile Bay capacity. The Commission finds that neither of these Exhibits supports the finding that because of the relationship between SOCO and WESCO no other shipper could have bid on Mobile Bay capacity. Ex. CE-5 is a Williams press release concerning the contract with SOCO and Ex. KSD-7 is a Transco Authorization for Expenditure. While both of these documents discuss the Mobile Bay project and describe the contract between SOCO and WESCO, they do not indicate that SOCO was the sole producer with access to the Mobile Bay project and no other shipper could subscribe to the Mobile Bay Capacity because it did not have access to gas supply. As Transco points out, the Ex. BP-1 at 2-5 shows that Transco and Amoco Production Company discussed shipping on the Mobile Bay Expansion Project. Amoco sought a firm transportation service with a flexible maximum daily quantity. Transco declined to offer that service and ultimately Amoco contracted for such service on Destin Pipeline of which it is an equity interest owner. In fact, Ex. BP-1 at 5 states that there are advantages to shipping on Destin as opposed to Transco's Mobile Bay Expansion. The testimony states that "Transco's MBX facilities are connected only to Transco's mainline facilities, and thus, do not offer access to multiple downstream markets and the economic opportunities associated with those markets."

106. In the present case, Transco posted an open season announcement for services on the proposed Mobile Bay project, specifically stating the proposed initial rate to be its Zone 4A rate and, further, that Transco would seek to roll in the facilities' costs. Any

and all shippers were free to subscribe to these services. Thus, we see no reason to believe that Transco improperly favored its affiliate.

107. The ALJ made a finding that there would be an unreasonable subsidization of Transco's affiliate by existing customers because the affiliate would receive 100 percent of the benefits of the expansion while only shouldering approximately 40 percent of the costs. The ALJ stated this means the existing customers will become responsible for 62.1 percent of the costs. The ALJ cites to KeySpan's Initial Brief at 24 to support this position as well as to statements contained in Brooklyn Union, where the court stated arguments concerning subsidization require a hard look. However, there appears to be no record evidence supporting the proposition in this proceeding. This argument concerning subsidization of Transco's affiliate was first made in the Mobile Bay certificate proceeding by Southern Natural Gas Company. See Southern's May 28, 1992 Protest in Docket No. CP97-92-000. The Commission finds that reliance on such evidence to assert that Transco's affiliate will receive a rate subsidy of about 60 percent is flawed.

108. In its calculations, Southern estimated the total portion of the Mobile Bay investment Transco would recover from WESCO over the 15-year term of its contract, assuming among other things that the investment in the Mobile Bay project is depreciated based on a system depreciation rate of slightly over 40 years. Inevitably, this calculation showed that over the 15-year contract term WESCO's contract, Transco would recover only about 40 percent of the total investment in the Mobile Bay project. This calculation does not show that Transco's existing customers will subsidize any portion of the Mobile Bay costs, let alone 60 percent. In order to find such a subsidy by existing customers not using the Mobile Bay facilities, we would have to also find: (1) Transco's affiliate will not renew its contract after the initial 15-year term, since otherwise it would continue to pay the Mobile Bay costs, (2) no other party will contract to use the Mobile Bay facilities after the expiration of the affiliate's contract, and (3) as a result, the Commission will permit Transco to shift all the remaining costs of the now empty Mobile Bay capacity to its existing customers. In short, the assertion that the existing customers will be required to subsidize 60 percent of the costs of the Mobile Bay project is based on highly speculative assumptions of what might or might not happen 15 years into the future.

109. Southern's calculation provides no basis whatsoever to find any subsidy by the existing customers during the first 15 years the Mobile Bay project is in service. The only probative evidence in the record of this proceeding concerning a cost shift as a result of rolling in the Mobile Bay costs is the uncontested evidence that rolling in the costs will increase the rates of the existing customers in this rate case by less than five percent. There is no evidence that such a small cost shift will give Transco's affiliate a competitive advantage in the market place or adversely affect competitors such as Destin. Indeed, the evidence cited by the ALJ (I.D. at P 115) that Destin and Dauphin Pipelines

have provided more gas supply to the Transco mainline than the Mobile Bay project undercuts any notion of competitive harm to them.

110. Accordingly, for the reasons discussed above, the Commission reverses the ALJ's finding that Transco's proposal to roll in the costs of the Mobile Bay Expansion project is unjust and unreasonable.

### E. Fuel and Electric Power Charges for Mobile Bay, Cherokee and SouthCoast Expansions

111. Transco's system includes approximately 350 compressor units that are powered either by natural gas or electricity. Pursuant to sections 38 and 41 of the General Terms and Conditions of Transco's tariff, the fuel and electric power costs associated with operating all these units are charged to mainline transportation service on a system-wide basis. Those sections of Transco's GT&C contain no separate provisions concerning compressors built in expansion projects. As a result, Transco has consistently included the costs of operating any compressors added in expansions in its system fuel reimbursement percentages and its system electric power surcharge. Consistent with this practice, the fuel and electric costs of operating compressors that were built as part of the Mobile Bay and Cherokee expansions discussed above, as well as for another expansion, the SouthCoast expansion, are included in fuel percentages and electric power charges applicable to all shippers. The Commission issued a certificate for the SouthCoast expansion in 2000.[29] That project expanded Transco's existing system in Alabama and Georgia by adding mainline looping, as well as a gas powered compressor at Station 105 in Alabama, and an electric powered compressor in Georgia. The Commission applied its 1999 Pricing Policy in the SouthCoast certificate proceeding. Because rolling in the costs of the SouthCoast expansion would increase Transco's existing FT shippers' rates by up to 2.24 percent, the Commission required that Transco use an incremental rate design for the SouthCoast expansion.

112. A number of parties filed evidence presenting proposals pursuant to NGA Section 5 challenging Transco's existing tariff provisions governing recovery of compressor fuel and electric power costs for the Mobile Bay, Cherokee, and SouthCoast expansion projects. The parties argue that applying system fuel percentages and system electric charges to the Mobile Bay, Cherokee and SouthCoast expansion projects would result in Transco's existing shippers providing subsidies to the expansion shippers. The parties argued that the proper remedy is the establishment of incremental charges

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[29] Transcontinental Gas Pipe Line Corp., 91 FERC ¶ 61,180 (2000).

whereby fuel and electric power costs of new compression installed in these projects would be assigned to each individual expansion.

113. The ALJ found that Transco's tariff should be amended to reflect incremental rates on the fuel and electricity charges for the Mobile Bay, Cherokee and SouthCoast expansion facilities. The initial decision stated that incremental rates for the fuel and electricity charges are in accord with the 1999 Pricing Policy. The ALJ found that the evidence shows that the added compression the Mobile Bay, Cherokee and SouthCoast facilities provide was not added to the Transco system to provide a service to the pre-expansion customers. The initial decision states that Transco has offered no evidence demonstrating a need for the added compression by the existing customers, even if they benefit from enhanced system flexibility due to their operation. The ALJ states that burdening existing customers with the costs for which expansion customers benefit flies in the face of the Commission's 1999 Pricing Policy. The ALJ held that to the extent possible, Transco must identify the amount of compression used by expansion shippers and charge them incrementally for the fuel and electricity associated with such compression. The ALJ held that this conclusion was consistent with the Commission's actions in similar cases.[30] The ALJ stated that this body of Commission precedent permitted him to conclude that the parties had met the first prong of their Section 5 burden of proof, showing that the existing rolled-in charges are unjust and unreasonable.

114. The ALJ stated that the opponents of rolled-in fuel and electric costs met the second requirement of Section 5 by offering a just and reasonable alternative to the existing methodology. The parties proposed that Transco use its most recent operating experience to develop the fuel retention percentages. They stated that the fuel retention percentage for Mobile Bay should be 1.14 percent. For the Cherokee and SouthCoast facilities, the parties suggested that the most recent data available to Transco should be the basis for the calculation. The ALJ stated that this approach was a good start. The ALJ found that a reasonable allocation of fuel and electric power costs to incremental customers based on the incremental compression relative to the overall compression is just and reasonable and appropriate. The ALJ concluded that the parties have compellingly shown that Transco must amend its tariff to include incremental pricing for fuel and electricity costs for compression and that it must develop a method, based on ConEd and Philadelphia Gas Works' suggestion, to accurately capture such costs.

[30] Citing, PG&E Gas Transmission, Northwest Corp., 99 FERC ¶ 61,366 (2002); Kern River Gas Transmission, 98 FERC ¶ 61,205 at 61,724, reh'g denied and certificate issued, 100 FERC ¶ 61,056 (2002); Texas Eastern Transmission LP, 99 FERC ¶ 61,383 (2002).

115. On exceptions, Transco asserts that the decision's revision of Transco's tariff regarding fuel and electric power charges is unjustified. Transco argues that the initial decision fails to comprehend that the parties challenging Transco's existing fuel and electric power cost allocation method cannot satisfy their NGA Section 5 burden merely by asserting that a different methodology might be preferable, or that application of the Commission's 1999 Pricing Policy might yield a different result if the existing methodology were proposed de novo as part of an initial rate. Transco states that contrary to the initial decision, the undisputed evidence shows that (1) Transco maximizes system operational efficiency by routinely using all of its facilities to serve all of its customers without regard for which services the customer have scheduled or in fact use, and (2) that such operations make it impossible to associate use of any particular facility with any particular service or group of customers. Transco argues that this evidence logically precludes a finding that Transco's tariff does not provide for a reasonable allocation of costs.

116. Transco also contends that the initial decision cannot be reconciled with the second prong of the NGA burden of proof, i.e., that the proponents of change must demonstrate that any proposed replacement is just and reasonable. Transco asserts that none of the parties seeking Section 5 changes to Transco's system-wide fuel and power allocation offered any specific alternative methodology for isolating and assigning Transco's compressor fuel and electric power costs to the Mobile Bay, SouthCoast and Cherokee expansion services. Transco states that the parties advance only theoretical concepts for an alternative methodology –concepts that the ALJ himself was constrained to characterize merely as a "good start." I.D. at P 185. Transco asserts that the fact that the ALJ ultimately imposed on Transco the burden of developing an alternative methodology, I.D. at P 186, turns the Section 5 burden on its head.

117. The Transco Municipal Group also filed exceptions, asserting that the ALJ erred by requiring Transco to implement incremental fuel rates for the Cherokee and SouthCoast Expansion projects. TMG states that the premise underlying the ALJ's ruling is that existing shippers are being required to subsidize incremental shippers. TMG argues that the record is devoid of evidence to support this conclusion regarding the SouthCoast project and indeed the evidence that does exist on this issue is largely ignored in the initial decision. TMG states that the ALJ cannot sustain the burden imposed by NGA Section 5 without a clear evidentiary basis for finding the status quo is no longer just and reasonable for the SouthCoast and Cherokee projects. Moreover, TMG states that the ambiguous incremental fuel cost recovery method he adopted in lieu of the Commission approved system-wide method is unsupported by the evidence and cannot be shown to be just and reasonable under Section 5. TMG states that the ALJ's ruling adopts a wholly undefined electric power cost recovery method and leaves it up to

Transco to decipher and apply his ruling. TMG asserts that there is no evidence to support the alternative cost recovery method for the SouthCoast and Cherokee projects, and in fact no clear and definite cost recovery method was advanced in testimony or defined in the initial decision.

118. AGL also filed an exception to the initial decision, arguing that the ALJ erroneously found that the proponents seeking a change to the existing provisions of Transco's tariff, which provides for the use of system-wide fuel and electric charges, have satisfied the dual Section 5 burden of demonstrating the unreasonableness of Transco's existing tariff and the reasonableness of their proposed tariff revisions. AGL asserts that there can be no finding that the proponents of the change in the fuel and electric charges have met this burden because they have not proposed an incremental fuel and electric charge or even a methodology for calculating such a charge.

119. Staff does not agree that the Mobile Bay fuel costs should be recovered incrementally. Staff states that the Commission predetermined that the costs of the Mobile Bay Expansion should be rolled into system rates. Staff asserts that should the Commission approve the roll-in of Mobile Bay costs, Transco's system-wide fuel tracker would be suitable for those Mobile Bay facilities. Staff does believe, however, that the ALJ correctly found that fuel and electric power costs for the Cherokee and South Coast projects should be recovered on an incremental basis.

120. Several parties filed briefs opposing exceptions asserting that the ALJ's initial decision should be affirmed.

**<u>Commission Decision</u>**

121. The Commission reverses the ALJ with respect to the fuel and electric costs of compressors added as part of the Mobile Bay project. However, the Commission affirms the ALJ with respect to the Cherokee and SouthCoast compressors. As discussed above, the Commission is applying the 1995 Pricing Policy to the Mobile Bay expansion, and the Commission has held that the costs of the Mobile Bay expansion may be rolled in. It follows that Transco should be able to collect the costs of fuel and electricity for compression on a system-wide basis as provided by Transco's tariff. Further, no party has shown that rolling in of the fuel costs results in a significant rate impact. As Staff has shown, the increased fuel use needed to operate the additional compressors added as a result of the Mobile Bay Expansion and attributed solely to the expansion shipper TEMCO is 483,726 Dth over the test period. That fuel usage represents about a 0.91 percent increase in fuel use on a system-wide basis. Ex. S-37 at 15-17. Since the rate impact is less than five percent and Transco has shown sufficient general system benefits of the roll in, the parties have not met their Section 5 burden requesting incremental fuel

rates for Mobile Bay. Accordingly, the ALJ's decision requiring Transco to reflect incremental rates for the fuel and electricity charges for the Mobile Bay Expansion is reversed.

122. The Commission will now turn to the fuel and electricity charges for the Cherokee and SouthCoast expansions. Above, the Commission has held that the 1999 Pricing Policy Statement must be applied to the Cherokee expansion. Moreover, in the SouthCoast certificate order, the Commission held that the 1999 Pricing Policy Statement should also apply to that project. The Commission has reviewed the initial decision and the briefs on and opposing exceptions and agrees with the ALJ's finding that to continue to allow Transco to charge system-wide rates to incremental shippers would result in the existing shippers subsidizing expansion shippers in contravention of the 1999 Pricing Policy Statement. As the evidence in this case shows, the annual cost of electricity used by the Station 115 Cherokee compressors is $2,380,399. However, Cherokee shippers pay only $135,151 annually in electricity costs, resulting in a $2,245,248 subsidy from existing shippers. ConEd Brief Opposing Exceptions at 9-10; Ex. CE-8 at 14. With respect to the SouthCoast facilities, the evidence shows that as result of the new South Coast Station 115 compression, Transco's generally applicable electric charges went up between 11 and 17 percent depending on rate zone. Ex. CE-24 at 4.

123. Transco has not disputed that existing customers are subsidizing incremental shippers through the existing system-wide fuel and electric charges. Rather, Transco has only argued that since its system is operated on an integrated basis, all shippers benefit from added compression and this supports continued use of the system- wide fuel and electric charges. The Commission finds that such generalized assertions are not enough to overcome the 1999 Pricing Policy Statement's prohibition against subsidies to incremental shippers. The Commission also finds that the fact that the Commission has approved system-wide fuel and electric rates for other incremental projects does not prevent it from changing Transco's methodology here. In fact, the Commission stated "that the appropriate forum for reexamining the current tariff's treatment of fuel charges for existing and expansion shippers on Transco's system is Transco's next NGA Section 4 rate case where all relevant factors may be examined. [Footnote omitted]. Those factors include the appropriateness of using system-wide versus incremental fuel rates for all system expansion customers, the overall pipeline volumes transported and the price of fuel. [Footnote omitted]." 98 FERC ¶ 61,086 at 61,256 (2002).

124. The Commission also affirms the ALJ's finding that the just and reasonable replacement for the system-wide fuel and electric power cost rates charged to the Cherokee and SouthCoast shippers is an incremental rate for electric compression based on Transco's most recent operating experience. In fact Transco, in its brief on exceptions concedes that "[t]here is no question that Transco can determine how much fuel or

electric power is used to operate any particular compressor unit over a particular time." Transco Brief on Exceptions at 18. As stated by Con Ed in its brief, the structure for fuel and electric charges should be as described in Northwest Pipeline Corporation, 99 FERC ¶ 61,365 at P 37 (2002) where the Commission stated that "expansion shippers are to pay both the compressor fuel rate charged to existing shippers and any additional fuel costs attributable to the proposed expansion, with the additional fuel costs captured in the surcharge. . . . The incremental fuel surcharge is intended to amount to the difference between the proposed incremental fuel rate and the existing compressor fuel rate." Therefore, within 30 days of the date of this order Transco is directed to submit a compliance filing containing incremental fuel and electric charges for the Cherokee and SouthCoast expansions.

## F. The Allocation of Certain Storage Costs Between and Among Storage and Transportation Services, the Resolution to be Prospective Only

### 1. Proposed Allocation of Transco's General Storage Function Costs

125. This issue involves allocation of Transco's storage facilities' costs among its existing transportation and storage customers. A group of customers led by Atlanta Gas Light (herein referred to as AGL) advocated a change to Transco's existing methodology for allocating storage costs to transportation services.

126. Transco currently allocates 15 percent of the costs of Washington storage field and the Transco owned portion of the Wharton and Leidy storage fields to transportation services. The remaining 85 percent of these costs are allocated to the bundled storage customers that purchase the services provided by use of these facilities. None of the fixed storage costs associated with storage services purchased by Transco from third parties are allocated to system services; all are allocated to the storage service schedules (GSS(DTI), LSS, SS-2, and S-2) that rely on the particular storage services Transco purchases. Transco also allocates 60 percent of the costs of the Eminence storage field and approximately 75 percent of the costs of the Hester field. This results in an allocation of slightly over $20 million of storage costs to transportation services.[31]

127. At hearing, AGL sought a substantial increase in the allocation to transportation services. It sought to allocate 22.5 to 26.2 percent of the Transco-owned portion of the Wharton and Leidy storage fields, as well a similar percentage of the third party storage

[31] Transcontinental Gas Pipe Line Corp., 99 FERC ¶ 61,002 at 61,014-7 (2002).

fields supporting the LSS, SS-2 and S-2 services to transportation. Moreover, it sought to increase the allocation of Washington field storage costs to 36.4 percent. AGL argued that Transco provides daily and hourly flexibility to its no-notice transportation customers, and that results in large physical imbalances on Transco's system which are made up by Transco's LNG facility. AGL asserted that Transco takes into account the demands of storage and transportation customers in scheduling daily injections to and withdrawals from storage, and that Transco relies on its storage facilities and services to serve contract storage and to manage transportation imbalances. AGL's witness, after analyzing Transco's storage operations over a three-year period, concluded that Transco uses all of its storage capability on an integrated basis to provide balancing service to its transportation customers.

128. AGL argued that Transco's current methodology is unjust and unreasonable because Transco permits transportation customers to create imbalances and then uses storage services to remedy the imbalances, and does not allocate costs from all storage fields to the transmission function. AGL argued that, since Transco uses a variety of other tools to provide system flexibility, and allocates those costs to various services, so too should Transco allocate costs from all storage services to those services. AGL further argued that since imbalances have increased on Transco's system, the level of storage costs allocated to those services that remedy the imbalances should be increased.

129. Transco found fault with the premises upon which AGL's conclusions are based. First, Transco disputed AGL's assertion that all system use benefits only transportation customers because Transco employs a contingency ranking procedure that ranks storage and transportation the same for no-notice service. Transco argued that a large probability of error exists in AGL's analysis because AGL analyzed Transco's storage operations on a daily basis in isolation from other days.

130. Staff and others argued that AGL had not met its Section 5 burden to show that Transco's current methodology is unjust and unreasonable. They argued that AGL's method of analyzing Transco's storage operations is inaccurate in several respects. Staff and others also argued that AGL's position that use of the Equitable method of allocating storage costs was not necessary is inappropriate. All parties agree that Equitable is generally the Commission's preferred method. Staff argued that Transco's proposed cost allocation is comparable to that which results from the application of the Equitable methodology.

131. The ALJ found that AGL had not demonstrated that Transco's storage cost allocation is unjust and unreasonable. The ALJ based this conclusion on his finding that Transco did demonstrate that AGL's analysis is flawed and therefore the conclusions based on that analysis have not been shown valid. The ALJ also found that AGL's

conclusions and proposed cost allocation deviate from the application of the Equitable method for allocating storage costs. The ALJ concluded that Transco's current allocation of storage costs to transportation services is just and reasonable.

132. AGL argues on exceptions that the ALJ misunderstood the level of storage costs allocated to transmission because the ALJ refers to the allocation of 15percent of costs from GSS, LSS, SS-1, SS-2, S-2 and Washington storage to transportation services, while in fact Transco does not allocate any costs from LSS, SS-1, SS-2, and S-2 to transportation services. Piedmont, and the Transco Municipal Group also point out the ALJ's misstatement, but argue that it is just that, a misstatement, and that it does not alter the ALJ's conclusion that AGL has not demonstrated that Transco's existing allocation of storage costs to transportation services is unjust and unreasonable. Transco Municipal Group also points out that elsewhere the ALJ correctly refers to the allocation of Washington, Leidy and Wharton storage costs to transportation services.

133. AGL argues that because the ALJ found that the Eminence storage costs previously allocated to FT services must be unbundled, transportation services are allocated even less storage costs than before, and this supports AGL's contention that more costs must be allocated to transportation services from other storage services. AGL further argued that the ALJ unreasonably rejected evidence presented by its witness and incorrectly found that Transco's analysis of its storage use refuted AGL's evidence. AGL argues that its analyses and evidence support a finding that Transco's current allocation of storage costs to transportation services is unjust and unreasonable.

134. Transco and other parties argue that the ALJ correctly ruled that AGL's analysis was flawed and that the conclusions and recommendations based on that analysis had no basis. Transco cites its witness's rebuttal of the AGL analysis as well as the evidence presented by several other parties.

**Commission Decision**

135. For the reasons discussed in the Initial Decision, the Commission affirms the ALJ. Transco's method for allocating storage costs to transportation services has been previously found to be just and reasonable,[32] and Transco does not propose to change that method here. Therefore, AGL has a two-pronged Section 5 burden to demonstrate that Transco's existing method is unjust and unreasonable, and that AGL's proposal is just and reasonable. The Commission finds that AGL did not show that Transco's method of

[32] Id.

allocating storage costs to transportation services is unjust and unreasonable, and thus has not met its Section 5 burden. The ALJ found that the analysis performed by AGL was flawed, and that conclusions based on that analysis had no factual basis. We are particularly persuaded by the basic flaws the ALJ found in AGL's analysis of Transco's storage usage. AGL erred in assuming that system use benefits only transportation customers, while in truth it benefits both storage and transportation customers. AGL did not perform an analysis of the extent to which line pack, compression, and other tools used for system operations benefit storage customers as well as transportation customers. AGL's analysis of Transco's storage usage on a daily injection/withdrawal basis exaggerates the extent that transportation customers benefit.

136. As to the unbundling of the Eminence storage costs from FT service, the Commission finds that has no bearing on storage cost allocation to transportation services per se. The Eminence storage costs that were allocated to FT service were for emergency service provided with the Eminence assets. With the unbundling of those costs, transportation customers will continue to pay costs associated with the Emergency Eminence service, but on an unbundled basis.

### 2. <u>Proposed Allocation of LNG Storage Facility Costs</u>

137. Transco allocates 100 percent of LNG storage facility costs to contract storage services. Staff argued that does not take into account the roll LNG plays in system management, and advocates a 15 percent allocation of those costs to system management. Staff analyzed Transco's utilization of LNG in system management by considering (1) daily physical net injection/withdrawal and physical storage inventory volumes; (2) daily contract storage injection withdrawal and inventory volumes; (3) LNG contract deliverability and capacity and actual injection/withdrawal data and (4) certificated parameters for the LNG facility. Staff observed that large differences between customer nominated/allocated volumes and actual physical injections and withdrawals from the LNG facility on three-day peak periods have occurred in the most recent three years. From this, Staff concluded that Transco relies heavily on LNG for system management, and that without the LNG availability, Transco would have to upgrade its supply to service peak loads. Staff argued that because LNG provides such a supporting role to system management, Transco should allocate LNG costs to system management. Staff developed allocation factors which result in allocating 15 percent of LNG costs to system management.

138. Transco and other parties argued that Staff has failed to show that the current allocation of storage costs to transportation is unjust and unreasonable. They alleged that Staff examined LNG utilization separately from other storage, rather than examining storage as a whole, and thus ignored the other storage costs that are currently allocated to

transportation services. Transco argued that its contingency ranking system exaggerates daily differences between physical and customer-allocated LNG withdrawals, and that failure to consider this and the fact that Transco operates the LNG facility as efficiently as possible, invalidates Staff conclusions based on the differences between customer inventory and physical inventory.

139. Indicated Shippers argued that Staff does not recognize the fact that there are no transportation costs allocated to LNG service, even though it is a bundled service. Because LNG customers enjoy transmission benefits without bearing transmission costs, transmission customers should not have to bear the burden of LNG costs. Indicated Shippers also argued that Staff fails to recognize that LNG is last in Transco's contingency, and that Transco withdraws gas from the LNG facility at peak periods in anticipation of LNG customer needs, not for use in system management.

140. The ALJ found that Staff had shown that Transco's practice of allocating no LNG costs to transportation services is unjust and unreasonable, and that Staff had fully supported allocating 15 percent of LNG costs to transportation service is an appropriate level. The ALJ ruled that, since no party had challenged Staff's calculations, he would adopt them as they were presented in the record. The ALJ was convinced that Staff had considered Transco's system operations in analyzing LNG usage, and, by demonstrating the magnitude of the differences between actual physical LNG withdrawals and injections and customer withdrawals and injections, Staff had demonstrated that Transco's allocation of zero dollars of LNG costs to system operations was unjust and unreasonable. The ALJ also found the argument espoused by Indicated Shippers and others that since no transmission costs were allocated to LNG services, LNG costs should not be allocated to transmission services to be without merit.

141. On exception, Transco argues that Staff has not shown Transco's allocation to be unjust and unreasonable because Staff did not look at Transco's use of storage as a whole, but rather, looked at LNG usage in isolation. Transco also argued that its contingency ranking system exaggerates differences between physical and customer allocated LNG withdrawals. .

142. AGL argued that Staff's allocation percentage is too low, and AGL's proposed allocation of 26.2 percent is more appropriate. Piedmont, Con Ed, Northeast Energy Associates, and Indicated Shippers, and the Transco Municipal Group argued that the ALJ failed to recognize the unique operating characteristics of Transco's LNG facilities, and failed to realize that they are operated as part of an integrated system.

**Commission Decision**

143. The Commission finds that the ALJ erred in finding that the Staff analysis demonstrates that Transco's current practice of allocating no LNG costs to transmission is unjust and unreasonable. The ALJ relied on Staff's evidence that there were large differences between customer nominated/allocated volumes and actual physical injections and withdrawals from the LNG facility in order to conclude that Transco's LNG operations are used substantially to support system management. The Commission finds that the ALJ's conclusion is flawed in that it fails to accurately consider the actual LNG operations on Transco's system, and the limitations on usage of LNG facilities.

144. Transco's LNG facility is expensive to use, and is the most expensive source of gas for LNG customers. Because it is uneconomic to inject and withdraw gas in relatively small quantities on a daily basis, Transco conducts a batch processing operation wherein it accumulates customer nominations until a large enough batch is available to make injection or withdrawal economic. To accommodate relatively small customer nominations, Transco relies on line pack, compression, and other system tools rather than withdrawing or injecting these small quantities into the LNG facility. Those quantities are then replaced when Transco makes its large withdrawals from the LNG facility. This practice can result in large disparities between customer nominations/allocations, and the actual physical withdrawals and injections. The ALJ failed to fully consider these operational characteristics in finding Transco's existing practice of allocating zero LNG costs to system management is unjust and unreasonable. In addition, LNG is not readily available on an hour-by-hour basis for system management because it takes two days for Transco to be able to deliver regasified LNG from the LNG facility.

145. An additional flaw in the ALJ's conclusion is his failure to fully consider Transco's contingency ranking system as an additional source of differences between customer nominated/allocated injections and withdrawals and the actual physical injections and withdrawals. Because LNG is usually ranked last because of its cost relative to other sources of supply, Transco is hindered in planning how much LNG to withdraw/inject on any day, and this leads to disparities between customer nominated/allocated amounts and actual physical withdrawals and injections. For these reasons, the Commission finds that the ALJ erred in concluding that Staff met its burden of proof to show that Transco's current and proposed allocation of LNG costs is unjust and unreasonable.

### G. **Unbundling of the Emergency Eminence Storage Withdrawal Service**

146. Transco's Eminence storage facility in Covington, Mississippi is an underground, salt dome storage field with a working capacity of 15 Bcf, daily withdrawal capability of 1.5 Bcf, and daily injection capability of 0.1 Bcf. It is located downstream of Compressor Station No. 65, the demarcation between the production and market areas. The Eminence facility is used to provide two separate services. The first is a contract storage service under Rate Schedule ESS (Eminence Storage Service). The second is the Emergency Eminence Storage Withdrawal Service which is embedded in the FT service of FT shippers. Section 6 of Rate Schedule FT governs the Emergency Eminence Withdrawal Service and provides that it is available to shippers that have transportation entitlements at the point on Transco's mainline system where the mainline facilities and the Eminence facilities interconnect, as a backup supply during force majeure events. Emergency Eminence Service is limited to an aggregate daily withdrawal quantity of 60 percent of the total daily withdrawal capability. Shippers who use this service must inject gas back into the Eminence storage facilities within 30 days or incur penalties. The costs of Eminence storage are divided between those same two categories for cost allocation purposes. Approximately 40 percent of Eminence storage costs are allocated to Rate Schedule ESS, while the remainder is recovered through FT rates in association with the so-called Emergency Eminence Service.

147. In Transco's Docket No. RP95-197-000 general Section 4 rate case,[33] the Commission ordered a change in the allocation of the costs of the Eminence storage fields that are included in the FT rates. Because not all FT shippers have mainline entitlements at Covington, Mississippi, (where Eminence interconnects with the mainline), not all FT shippers were able to use the Emergency Eminence Storage Service embedded in the FT rate schedule. The Commission ordered that the costs be allocated only to FT shippers that have mainline entitlements at Covington and that this be accomplished by placing the costs in a separate charge to be paid by all FT shippers with mainline entitlements at Covington. On December 20, 2002, the Commission accepted Transco's filing to comply with the orders in the Docket No. RP95-197-000 rate case. 100 FERC ¶ 61,321 (2002).

148. Staff and AGL proposed to unbundle the Emergency Eminence Storage Service currently embedded in the FT rate schedule from the FT service and put it into a separate rate schedule so that shippers with transportation entitlements at Covington can decide

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[33] Transcontinental Gas Pipe Line Corp., 82 FERC ¶ 63,019 at 65,191-2 (1998), order on initial decision, 87 FERC ¶ 61,087 (1999).

whether to take the service, whereas previously they had to take the service. Transco opposes each proposal. AGL's proposal is to provide shippers with a one-time, all-or-nothing opportunity to acquire additional storage rights under Rate Schedule ESS, and at the same time to eliminate Transco's obligation to provide Emergency Eminence backup service to converting shippers to the extent that customers elect to convert these emergency backup rights to storage rights. The new ESS rights would be apportioned to existing FT shippers that pay for Eminence force majeure costs, commensurate with their firm mainline entitlements at Eminence. Eminence storage capacity would continue to be fully subscribed. The costs formerly associated with the Eminence force majeure backup service capability would be allocated to Rate Schedule ESS for rate design purposes. Staff's proposal would require Transco to unbundle its Emergency Eminence Service from Rate Schedule FT and create a separate Emergency Eminence Service. Only those shippers who nominate unbundled Emergency Eminence Service would be required to pay for it. Transco would be at risk for any unsubscribed Emergency Eminence capacity.

149. The ALJ found that Transco must unbundle its current Emergency Eminence Storage Withdrawal Service from its FT service. The ALJ adopted Staff's proposal to set up a separate rate schedule for the Emergency Eminence Service that would give shippers the option to contract for the service and would charge the unbundled rate only to those shippers who use the service. Approximately $13 million would be allocated to the new service. The billing determinants for delivery and capacity would be 60 percent of the maximum delivery and capacity as specified in Transco's Rate Schedule FT tariff. AGL also proposed to unbundle the Emergency Eminence Storage Withdrawal Service. However, it proposes that the service be incorporated into an additional ESS contract storage service. The ALJ held that Staff's proposal fairly addresses Transco's concern of who will absorb the costs of the unbundled but not fully subscribed service. The ALJ stated that although Staff based its calculations on a fully subscribed Emergency Eminence Service, it proposes that any unsubscribed portion could be recovered from ISS shippers or Transco could offer a new Eminence storage service based on the unsubscribed deliverability and capacity. Ex. S-53 at 13. The ALJ found that if these methods continue to leave unsubscribed capacity then Transco will be at risk for the costs and appropriately so.

150. The ALJ found that the proponents of unbundling persuasively justify the change in the character of the Emergency Eminence Storage Service because there is no operational or other justification for the continued bundling of that service in the FT service. The ALJ found that unbundling of the service is fully consistent with the Commission's policies that support unbundling of services to the fullest extent

practicable. The ALJ found that unbundling in this situation would advance the Commission's objective of requiring customers who actually use the service to pay for that service.

151. On exceptions, Transco argues that the Commission orders in Docket No. RP95-197 only required a change in the allocation of the costs of Emergency Eminence Storage Service among the FT shippers, so that only those FT shippers with mainline entitlements at Covington would have to pay for the costs of the service. However, the Emergency Eminence Storage Service would remain a component of FT services so that all customers with mainline capacity at Covington would receive the service. Transco argues that the proposals in this case go well beyond what was decided in Docket No. RP95-197-000, i.e., they are proposals to unbundle the Emergency Eminence Storage Withdrawal Service itself, making it for the first time a stand alone emergency service (as proposed by Staff) or additional ESS contract service (as proposed by AGL) for which customers may elect to subscribe. Transco asserts that the proposal would fundamentally change the character of the Emergency Eminence Storage Service. Transco states that no FT customer currently has any rights to any portion of the Eminence field dedicated to Emergency Eminence Storage Withdrawal Service, since that service is not a contract storage service. Transco states that the Emergency Eminence Storage Withdrawal Service is an insurance policy, i.e., a service enhancement embedded in the FT service that is broadly available to all FT customers eligible to receive the service, in the event of supply emergencies. Transco argues the changing the nature of the service and placing Transco at risk for the recovery of millions of dollars of costs of service is not supported by the record. Transco asserts that there has been no showing that the current bundled service is unjust and unreasonable and that the new proposals are just and reasonable.

152. AGL filed exceptions supporting the ALJ's decision to require the unbundling of the service but asserted that the ALJ should have adopted its proposal rather than Staff's proposal.

153. A number of parties filed briefs opposing exceptions supporting the ALJ's decision.

**Commission Decision**

154. As a preliminary matter, the Commission recognizes that the issue concerning the unbundling of the Emergency Eminence Storage Service raised in this case is distinct from the allocation issue decided in Transco's previous Section 4 rate case. In the previous case, the Commission decided only that no costs related to the Emergency Eminence Storage Service should be allocated to FT customers who could not use the service because they lacked mainline capacity at Covington. However, costs continued to

be allocated to all FT shippers with capacity at Covington regardless of whether they actually used the service. The issue raised in this proceeding is whether the Emergency Eminence Storage Services should be unbundled from the FT rate schedule, so that FT shippers with capacity at Covington can decide whether or not to take, and pay, for the services.

155. Transco argues that the proponents of unbundling have not met their Section 5 burden by showing that the current bundling of the service into the FT service is unjust and unreasonable and that its replacement is just and reasonable. Transco also appears to argue that because the unbundling proposals change the character of the service they should be rejected. The Commission finds that Transco's arguments are without merit. The Commission finds that the ALJ correctly found that the bundling of the Emergency Eminence Storage Withdrawal Service with the FT service is unjust and unreasonable and that Staff's unbundling proposal was just and reasonable. As the Commission stated in the order concerning the unbundling of Transco's SS-1 storage service, "[u]nnecessary bundling of services such as storage and transportation is *per se* unjust and unreasonable. It is only when there are countervailing considerations that the bundling of services will be considered just and reasonable." 87 FERC ¶ 61,087 at 61,398 (1999). Customers should have the option of choosing whether to contract for separate and distinct services. Here, as the ALJ found, there are no operational or other justifications for continued bundling of the service. Transco has not presented any evidence on exceptions to contradict this conclusion. It does not argue that it uses the Eminence storage service in performing FT service. Rather, it has described the service as an alternative to receiving transportation service when the transportation service must be curtailed. As shown in the testimony, no shippers opposed the proposals and no shipper has utilized the Emergency Eminence force majeure capabilities since 1998. Ex. DPY-15 at 46.

156. The Commission affirms the ALJ's finding that Staff's proposal is a just and reasonable replacement because it implements the Commission policy of unbundling services to the greatest extent possible absent special circumstances that would justify the bundling of services. The ALJ also adequately explained that the Staff approach was more equitable than the AGL proposal because it allocated costs only to those FT shippers who actually sign up to use the service. In addition, the ALJ adequately explained that the Staff's approach addresses the issue of who will absorb the costs of the unbundled but not fully subscribed service.

### H. Including the Destin Shubuta Interconnect and Other Receipt Points as Part of the Station 85 Pooling Point

157. This issue involves the current physical pooling point at Station 85. BP argues that it should become a paper pooling point, while Transco argues that BP is trying to avoid paying transportation charges between the Destin interconnect and the Station 85 pooling point.

158. The Mobile Bay lateral intersects with Transco's mainline at Station 85 in Zone 4. Transco established Station 85 as its Zone 4 pooling point for aggregating gas supplies in 1992. Station 85 is located near the center of Transco's Rate Zone 4. Therefore, interruptible shippers who transport gas from upstream receipt points on Transco's mainline to the Station 85 pooling point use the Zone 4 mainline, and Transco charges them a rate for such deliveries to the Station 85 pooling point under Rate Schedule IT that includes payment for Zone 4 transportation. The Mobile Bay lateral, however, is in a separate rate zone, Zone 4A or 4B. Thus, shippers transporting gas from a receipt point on the Mobile Bay lateral to the Station 85 pooling point are not considered to receive any transportation along the Zone 4 mainline. Accordingly, Transco charges them the Zone 4A or 4B rate, but not any Zone 4 rate.

159. BP is a shipper on both Destin Pipeline Co. and Transco. It also owns a two-thirds interest in Destin. Destin interconnects with Transco at the Shubuta receipt point in Zone 4 upstream of Station 85. At the hearing, BP sought to have the Commission act under NGA Section 5 to require that Transco treat Station 85 as a paper pooling point so that all Zone 4 receipt points, including the Shubuta receipt point would be considered part of the pooling point. Under this proposal no shipper using Station 85 as a pooling point would have to pay the Zone 4 rate for deliveries to the Station 85 pooling point.

160. BP argued that the current treatment of Station 85 as a physical pooling point is unjust and unreasonable because (1) the Commission requires effective pooling, (2) it is unduly discriminatory, (3) it violates Commission policies, and (4) the Commission has refused to allow Transco to restrict pooling on its system.

161. First BP argued that the Commission requires effective pooling on pipeline systems, and that this necessarily includes paper pooling. The Commission further requires that gas can be delivered from receipt points and received at delivery points into/from at least one pool. (Order Nos. 636 and 587-F). BP stated that all other major pipelines similar in nature to Transco provide paper pooling at their pooling points.

162. BP argued that the current arrangement is unduly discriminatory because the only customers permitted to access the pool without paying a Zone 4 transportation charge are shippers on the Mobile Bay Pipeline. All other customers must pay a Zone 4 transportation charge to the pool. BP contended that this is unduly discriminatory because all shippers are not treated equally. In addition, the primary shipper on Mobile Bay is TEMCO, a Transco affiliate, and this arrangement is a violation of the Commission's affiliate regulations. This arrangement allegedly gives TEMCO a competitive price advantage over Destin shippers. BP also argued that Transco's current arrangement raises barriers to use of pooling for offsystem gas because Transco requires shippers to pay a transportation charge and to physically transport gas to Station 85. In addition, BP argued that Transco's current arrangement is unduly discriminatory because it requires those using the pooling service at Station 85 to physically purchase gas at Station 85 for delivery downstream. This economically precludes mainline shippers who have paid for capacity in Zone 4 from purchasing gas elsewhere and using the pooling service at Station 85.

163. BP next argued that Transco's current arrangement violates Commission policy by charging twice for pooling, once for delivery into the pool, and once for taking gas out of the pool. In addition, BP argued that since Transco only permits access to the pool from the Mobile Bay Pipeline without payment of the Zone 4 rate, it violates Commission policy which requires access to pools from multiple receipt points.

164. Finally, BP argued that Transco's pooling service at Station 85 results in a price advantage for TEMCO over Destin shippers, and inhibits competition in violation of Commission regulations and policy.

165. Transco argued that BP has not shown that the current use of Station 85 as a physical pooling point is unjust and unreasonable. Transco stated that all mainline capacity in Zone 4 is fully subscribed so there is no available additional capacity for transportation from Shubuta to the Station 85 pool. Transco also argued that the pooling arrangements at Station 85 are administrative in nature, and BP has not shown that a Shubuta shipper would have a reason to use the pool. Transco maintained opening the pool to shippers upstream would enable them to avoid paying transportation charges to the pool across Zone 4, and that the resultant unrecovered costs would eventually be shifted to Transco's firm shippers.

166. Transco also argued that the price differential between TEMCO and Destin shippers is due to the lower quality of service to Shubuta.

167. The ALJ held that BP had met its Section 5 burden by demonstrating that Transco's existing requirements concerning the use of Station 85 as a pooling point are unjust and unreasonable, and by suggesting a reasonable alternative. The ALJ found Transco's current arrangement to be unduly discriminatory because Transco does not treat all pooling points consistently across its system, and because shippers other than Mobile Bay shippers must pay a Zone 4 transportation charge to transport gas to the pool. Downstream shippers must pay another transportation charge in violation of Commission policy on pooling and impedes competition at Station 85.

168. The ALJ also relied on a previous Commission ruling denying an attempt by Transco to limit access to a pooling point at Station 65 to conclude that Transco's attempt here to limit access to Station 85 would also be unjust and unreasonable. Further, the ALJ referred to the Commission's decision in ANR v. Transcontinental Gas Pipe Line Corp.[34] in directing that Transco open Station 85 pooling to all shippers in Zone 4. Transco's affiliate relationship with TEMCO also contributed to the ALJ's finding of undue discrimination. The ALJ found that only TEMCO does not pay an IT rate to move its gas to the Station 85 pool, and is the only beneficiary of maintaining the status quo at Station 85.

169. The ALJ found that in addition to being unduly discriminatory, the current arrangement at Station 85 violates Commission policy on pooling because Transco charges two charges, one for shipment of gas to the pool and one for shipment out of the pool. The ALJ cites Commission regulations which specify that the pipeline can charge for shipment to the pool or for shipment out of the pool, but not for both when the pool is in a rate zone. Also, the ALJ concluded that the Zone 4 pool does not contain multiple receipt points which is contrary to the Commission's policy on pooling. Although Transco claims that other receipt points have access to the pool, they must pay the transportation charges which shippers on Mobile Bay do not have to pay. This creates an unfair economic barrier to access to the pool.

170. The ALJ found that the alternative which BP proposes, paper pooling at Station 85, is a reasonable alternative to the existing arrangement because it promotes competition through non-discriminatory, economic access to the pool. Shippers using the paper pool would not receive "free" transportation to the pool because they would continue to pay the IT rate from production laterals. No additional capacity on Transco's

[34] 91 FERC ¶ 61,066, reh'g denied 93 FERC ¶ 61,277 (2000)

mainline would be required because this would not be a physical pool, but rather a paper pool. The ALJ also found that the BP alternative is just and reasonable because it is consistent with other paper pooling arrangements on similarly situated pipelines.

171. On exceptions, Transco and the Transco Municipal Group argue that the ALJ's finding of undue discrimination is based on the false premise that Transco's affiliate, TEMCO, is the only shipper using the Mobile Bay lateral to ship gas to Station 85. Many other, non-affiliated shippers use that lateral to ship gas to Station 85. Transco also argues that its pooling services at Station 85 are no different that they are at other similarly situated pooling points at Stations 30, 45, 50, and 62. By establishing a paper pool that permits Zone 4 shippers to avoid transportation charges, the ALJ would set a rate structure that is unique on Transco's system. Interruptible transportation to which Transco has already allocated costs would be undercut by the ALJ's finding and would result in under recovery of costs. Transco maintains that BP's argument that Transco has erected an economic barrier to accessing Station 85 is wrong because all firm capacity in Zone 4 is fully subscribed, and firm shippers' use of flexible receipt and delivery points offers shippers access to Station 85 at no additional cost.

172. The Transco Municipal Group argue that the ALJ erroneously concluded that Mobile Bay shippers are getting a free ride to Station 85, while, in fact, they pay the Zone 4A and/or 4B rates. They argue that adopting BP's proposal would give shippers upstream of Station 85 a free ride, because they would avoid paying Zone 4 transportation charges.

173. Keyspan argues on exception that there is a difference in the way rates are designed (and approved by the Commission) for the supply laterals in Zone 4 and those in Zones 1, 2, and 3, and that there is nothing discriminatory about them. Keyspan stated that the Commission has held that it is appropriate for Transco to charge an interruptible rate for transportation to a pooling point and another interruptible rate for delivery from the pool because these are two separate transactions on Transco's system.

174. In opposing exceptions, BP raises the arguments it presented in its case, i.e., Transco raises economic barriers to all Zone 4 shippers except the Mobile Bay shippers, and Transco violates Commission policy by charging to transportation charges for pooling and by denying shippers access to at least one pool.

**Commission Decision**

175. The Commission finds that the ALJ erred in his finding that BP demonstrated that Transco's current physical pooling arrangement at Station 85 is unjust and unreasonable.

176. The ALJ based his finding in part on his conclusion that Transco operates its Station 85 pool differently than it operates the other pools on its system, i.e., interruptible shippers accessing the pool from the Mobile Bay lateral do not pay the Zone 4 IT rate and other interruptible shippers do, while at other pools all interruptible shippers accessing the pool must pay an IT rate. However, while Mobile Bay shippers do not pay the Zone 4 IT rate, they do pay the Zone 4A/4B IT rates to move gas to the mainline. In the case of the Mobile Bay lateral, its intersection with the mainline is the pooling point, so there is no need to transport the gas further and charge shippers an additional Zone 4 interruptible transportation rate. Shippers on the mainline upstream of Station 85 must move the gas to Station 85 across Zone 4, and must pay the Zone 4 IT rate. As Transco explains, pools in Zones 1, 2, and 3 in the production area pay an IT feeder rate to transport gas to the pools. While it is true that Transco's rate design results in a lower rate for Zone 4A and 4B than the Zone 4 rate, rate design is not the issue here, only whether shippers pay to get their gas to the pools across Transco's system, and the Commission finds this to be the case.

177. The ALJ also found that Transco's charging one rate for delivery to the pool, and another rate for delivery from the pool unjust and unreasonable, because such double charges are against Commission policy and raise an economic deterrent to using the Station 85 pool. However, in Opinion No. 405, the Commission previously rejected a similar contention that separate charges for transportation to a pooling point and transportation from a pooling point improperly inhibit the development of pools. The Commission stated that, in connection with the provisions in Transco's tariff giving interruptible service feeding firm service a priority over other interruptible service, the interruptible transaction moving gas to the pooling point incurs one charge, while the firm transaction moving gas away from the pooling point incurs a second charge. The Commission therefore found that an interruptible transaction moving gas away from a pooling point should also be treated as separate and distinct from the interruptible transaction which moved gas to the pooling point, with the result that two charges are also warranted in that situation.[35] The Commission sees no reason to reverse that finding in this case.

[35] 76 FERC ¶ 61,021 at 61,074-5 (1996) (Opinion No. 405), reh'g denied, 76 FERC ¶ 61,270 (1996).

178. The ALJ relied on a previous Commission order on a Transco proposal to eliminate the IT feeder priority and replace it with firm rate schedules.[36] However, there the Commission rejected Transco's proposal because it would result in a degradation of the rights of existing firm shippers to exercise flexible receipt and delivery points throughout the zone for which they contracted and paid for capacity. Transco does not, in its current operation of the Station 85 pooling point, prohibit firm shippers with Zone 4 capacity from making full use of their secondary point rights throughout the zone, including in order to engage in segmented transactions to move gas both to and from the pooling point pursuant to a single FT contract, without incurring separate charges for each transaction. Moreover, the Commission's rejection of Transco's proposal to eliminate the IT-Feeder service left in place the current tariff provisions under which IT transactions bringing gas to a pooling point incur one charge, while a separate charge is paid for the firm transaction taking the gas away from the pooling point, which was approved in Opinion No. 405. The Commission finds that the ALJ erred in relying on this case to find that Transco's current operation of the Station 85 pool is unjust and unreasonable. Similarly, the Commission finds that the ALJ erred in relying on the Kern River Gas Transmission Company (Kern River) decision.[37] There the Commission rejected a Kern River proposal to add more pooling points to its system and stated that shippers must be able to aggregate gas from multiple receipt points. In the current case, the ALJ held that Transco violates this definition of pooling. However, Transco has explained that shippers from other points can access the Station 85 pooling point by paying for the transportation of gas to that point. The Commission did not find in Kern River that shippers have an absolute right to access pools, no matter where they are located and without regard to the transportation necessary to get gas to the pool. Transco's current operation of the Station 85 pool does not conflict with the Commission's ruling in the Kern River case.

179. The ALJ based his finding, in part, on his conclusion that the affiliate relationship between Transco and its affiliate, TEMCO resulted in unduly preferential treatment of TEMCO because TEMCO is the only shipper which does not pay an interruptible transportation rate to move its gas to the pooling point. The ALJ's conclusion is based on an incorrect assumption because, although TEMCO is the largest shipper on the Mobile Bay lateral, it is not the only one. There are a number of additional shippers on the Mobile Bay lateral which pay the same rates as TEMCO, the Zone 4A or 4B IT rate.

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[36] 86 FERC ¶ 61,175 (1999).

[37] 98 FERC ¶ 61,079 (2002).

180. The Commission finds that the ALJ erred in determining that BP has demonstrated that Transco's current operation of its Station 85 pool is unjust and unreasonable. There is no need, therefore, to examine whether BP's alternative proposal, the paper pool, is just and reasonable. However, the Commission notes that there is not currently a requirement to provide paper pooling, and the Commission specifically refused to made such a finding in Order No. 587-F.[38]

### I. Allocation of Costs to Transco's Incrementally Priced Transportation Services and to Transco's Bundled Storage Service

181. Currently, Transco allocates transmission operation and maintenance (O&M) and administrative and general (A&G) costs between non-incremental transportation, incremental transportation, and the transportation component of GSS storage service based on demand Dth-miles and commodity Dth-miles.[39] Transco increases the amount allocated to GSS and incremental transportation services by 10 percent and decreases the allocation to system transportation services by a like amount.

#### 1. Allocation of O&M Expenses to Incremental Services

182. At the hearing, Staff claimed that Transco's allocation of O&M costs on a Dth-mile basis is unjust and unreasonable because O&M costs are direct costs incurred with respect to specific facilities and should be directly assigned to the sub-functions with which the facilities in question are associated. Staff argued that Transco's Dth-mile method of cost allocation has no relationship to the way in which O&M costs are incurred. Staff proposed that Transco be required to reorganize its accounting system so that it can account for O&M and any other direct costs so that they can be directly assigned to the facilities for which they were incurred.

[38] Standards for Business Practices of Interstate Natural Gas Pipelines, 81 FERC ¶ 61,181 (1997).

[39] Demand Dth-miles equals contract demand multiplied by contract path miles and commodity Dth-miles equals throughput multiplied by contract path miles.

183. Staff also argued that Transco's current allocation of O&M costs results in cost shifting between sub-functions and violates the Commission's 1999 Pricing Policy Statement[40] which requires that incremental expansion projects stand completely on their own without any subsidization by existing shippers. This is because the Dth-mile methodology does not separately identify the O&M costs incurred to operate and maintain the incremental expansion facilities, including pipeline looping and compressors.

184. Staff argued that because Transco does not currently have the accounting data to allocate costs directly to the sub-function that incurred them, then a reasonable allocation methodology for this rate case that is in line with Commission precedent[41] would be to allocate costs among sub-functions using the ratio of project gross plant to total transmission plant.

185. Transco argued that it is unable to account for O&M costs in the manner advocated by Staff because of the integrated nature of its operations. Transco stated that its accounting system has been in place for several years and has continued in place through two rate proceedings, and that Staff's proposal is unworkable and impractical.

186. The ALJ found Transco's current methodology for allocating O&M costs to be unjust and unreasonable based on Commission precedent, citing Northwest and Michigan Gas Storage Co.[42] The ALJ directed Transco to set up accounting systems that will accurately reflect the sub-functions for which O&M costs are incurred. Where this is impossible, the ALJ directed Transco to use the gross plant method set forth by Staff.

187. On exceptions to the initial decision, Transco argues that the ALJ reached incorrect conclusions by relying on the Northwest and Michigan Gas cases, neither of which apply directly to Transco's case. Transco claims that Staff did not make a case that Transco's current O&M allocation methodology is unjust and unreasonable, and furthermore, did not propose a suitable alternative. Transco argues that since Staff failed

[40] Policy Statement Concerning Certification of New Interstate Natural Gas Pipeline Facilities, 88 FERC ¶ 61,277 (1999), order clarified, 90 FERC ¶ 61,128 (1999), order clarified 92 FERC ¶ 61,038 (2000).

[41] Citing, among other cases, Northwest Pipeline Co., 87 FERC ¶ 61,266 (1999), reh'g, 92 FERC ¶ 61,287 (2000), compliance, 96 FERC ¶ 61,049 (2001) (Northwest).

[42] 87 FERC ¶ 61,038, reh'g, 89 FERC ¶ 61,131 (1999).

to propose an alternative accounting methodology that takes into account Transco's integrated facilities and operations, Staff has failed to uphold its burden under Section 5 of the NGA.

188. Energy Associates argues that due to the integrated nature of Transco's operations, it is impractical or impossible to directly assign costs to sub-functions. As a result, Energy Associates contends, Staff's reliance on precedent does not demonstrate that Transco's rates are currently unjust and unreasonable, nor does it demonstrate that the methodology advocated by Staff will result in just and reasonable rates.

189. In opposing exceptions, Staff argues that the ALJ correctly concluded from the record that Transco should establish an accounting system that will enable it to directly assign costs to the separate sub-functions. Staff states that Transco is wrong when it argues that the Northwest and Michigan Gas precedent relied upon by the Staff and the ALJ is not applicable to Transco. However, Staff notes that as part of the April 12, 2002 Stipulation and Agreement in this case approved by the Commission in July 2002, Staff withdrew its proposal that O&M costs be allocated based on gross plant ratios until accounting procedures are in place to directly assign these costs. Staff accordingly states that, while it does not oppose the ALJ's adoption of the gross plant method, it only advocates the direct assignment of O&M costs, and not a gross plant allocation of O&M costs.

**Commission Decision**

190. Cost allocation is not an exact science and no one method may be said to fit all situations. In deciding which cost allocation methodology to apply the Commission must sometimes conclude which is the more reasonable of the several alternatives. As the ALJ held, the Commission generally prefers that transmission O&M costs be allocated among transmission sub-functions, including incrementally priced expansion projects, based upon a direct assignment of these costs to the facilities for which the costs were incurred, to the extent such direct assignment is possible.[43] Direct assignment of costs is preferable because it more closely matches cost incurrence with cost responsibility. However, in this rate case, it is not possible to use the direct assignment method, because, as all parties concede, Transco has not accounted for O&M costs in a manner that makes direct assignment possible. After Staff withdrew its proposal to use plant ratios to allocate O&M costs, no party is left supporting that option. Nor has any party suggested any other alternative allocation method. In these circumstances, we have concluded that the

[43] Northwest, 87 FERC at 62,045. See also Michigan Gas, 89 FERC at 61,376.

most reasonable approach in this rate case is to permit Transco to continue to use its existing Dth-mile methodology for allocating O&M costs among transmission subfunctions.

191. However, consistent with our actions in Michigan Gas, involving a similar situation, we order that Transco prospectively modify its manner of accounting for these costs and directly assign them to the maximum extent possible. This will enable these O&M costs to be allocated in Transco's next rate case based upon the preferred direct assignment methodology. Staff's point about the need for incremental facilities to stand on their own is well taken. In its 1995 final rule on filing and reporting requirements for pipelines[44] the Commission stated that separate schedules and statements must be maintained for incremental expansion facilities so that rates can be evaluated based on the costs of those facilities. This is embodied in §154.309 of the Commission's regulations. Furthermore, in its 1999 Pricing Policy Statement the Commission again expressed its policy that pipeline expansion projects, in the absence of a predetermination of rolled-in pricing, must be able to recover their costs without subsidization by existing customers. Inherent in that statement of policy is that pipelines must be able to separately identify costs associated with expansion projects. Since the policy statement was issued, the Commission conditioned many of the certificates it has issued upon the pipeline maintaining separately identifiable accounts for expansion projects.

192. Transco asserts that it should not be required to separately identify costs associated with incremental facilities because of the integrated nature of Transco's operations. The Commission rejected a similar contention in Northwest. [45] The fact that a system is integrated does not mean that O&M costs cannot be directly assigned as between incremental and non-incremental facilities. For example, where a compressor included in an incremental project must be repaired, it should be possible to assign at least the labor and parts costs incurred in making that repair to the compressor in question. The Commission directs Transco to separately account for costs related to incremental facilities as required by Commission policy and Section 154.309 of the Commission's regulations and to utilize this accounting method in its next Section 4 rate case.

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[44] Filing and Reporting Requirements for Interstate Natural Gas Company Rate Schedules and Tariffs, FERC Statutes and Regulations, Regulations Preambles ¶ 31,025 at 31,406 (1995).

[45] 87 FERC at 62,044.

### 2. <u>Allocation of A&G Costs</u>

193. At hearing, Staff argued that Transco's allocation of A&G costs based on Dth-miles is unjust and unreasonable because there is no relationship between the two. Staff argues that the Commission has repeatedly reached this conclusion and has held that the K-N method,[46] whereby A&G costs are allocated on the basis of direct labor ratios and plant ratios, is the appropriate method for allocating A&G costs. Staff argued that Transco's current allocation methodology results in cost shifting and subsidization of incremental projects by system shippers.

194. Indicated Shippers also argued against the Dth-mile method and advocated that A&G costs be allocated on the basis of actual and imputed contract demand volumes. Indicated Shippers also argues that the Dth-mile method results in cost shifting and subsidization.

195. Energy Associates relied on a regression analysis by its witness in advocating the Dth-mile allocation methodology. Energy Associates argued that the analysis showed a strong correlation between a pipeline's A&G costs and Dth-miles.

196. Transco maintained that the parties had not met their burden of showing that Transco's current methodology for allocating A&G costs should be changed. Transco argued that the parties have not shown that there is a more logical connection between A&G costs and gross plant or contract volumes than there is between A&G costs and Dth-miles, Transco's current methodology. Transco Municipals supported Transco.

197. The ALJ, citing the Commission's longstanding policy that A&G costs should not be allocated on a mileage basis, found that Transco has failed to support its proposal. In addition, the ALJ found that Transco and Energy Associates have not shown any reason to depart from the Commission's long-preferred K-N method for allocating A&G costs to a pipeline's functions and sub-functions. The ALJ found that Indicated Shippers has failed to show a link between A&G costs and contract volumes, and that the regression analysis relied on by the Energy Associates witness was flawed and thus unreliable.

198. The ALJ found that the Staff proposal to use gross plant revenues as a surrogate to the full application of the K-N method is acceptable until Transco has developed a system that accounts for direct costs so that they may be directly allocated.

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[46] Kansas-Nebraska Natural Gas Co., 52 FPC 1691, 1721-22, <u>reh'g denied</u>, 54 FPC 923 (1975), <u>aff'd</u>, 534 F.2d 277 (10th Cir. 1976).

199. On exceptions, Transco argues that the ALJ erred in finding that Transco's allocation method must be changed because the parties have not met their burden in proving that Transco's existing method for allocating A&G costs is unjust and unreasonable.

200. Transco Municipals argue that the ALJ erred because the Staff proposal would be unworkable, and because Staff has not shown that its proposal is more reasonable than Transco's current method. Also, the interim method adopted by the ALJ, allocation based on gross plant ratios, is flawed because there has been no showing that there is a relationship between gross plant and A&G costs. The shifting of up to $5 million in costs to incremental customers is an unjust and unreasonable result of the adoption of the Staff proposal.

201. Indicated Shippers argues on exception that the ALJ erred in adopting the Staff proposal rather than its proposal for allocating A&G costs. Indicated Shippers, while agreeing that there is no relation between A&G costs and Dth-miles, argues that those costs should be allocated to all transmission shippers, both system and incremental, on a contract demand basis. Indicated Shippers states that the Commission has an established policy of allocating A&G costs among sub-functions on a contract demand basis.

202. Opposing the exceptions, Staff argues that the Commission has consistently ruled that A&G costs do not vary with mileage and therefore must not be allocated on a mileage basis. In addition, Staff states that the Commission has found that the K-N method should be used to allocate A&G costs at the sub-function level. Because Transco cannot currently identify direct labor costs associated with incremental services, the gross plant method of allocating A&G costs is the appropriate K-N allocation component to apply.

**Commission Decision**

203. The Commission affirms the ALJ on the issue of allocation of A&G costs among transmission sub-functions for the reasons stated in the initial decision. The Commission has repeatedly found that A&G costs do not vary appreciably with distance, and should not be allocated based on length of haul. In this case, Staff and Indicated Shippers have demonstrated that Transco's proposal, which relies on mileage and volumes, is unjust and unreasonable because there is no significant relationship between the A&G costs incurred on Transco's system and the mileage factor. It is the Commission's long-standing policy that A&G costs be allocated among functions based on direct labor ratios for labor-related costs and plant ratios for plant-related costs. The same reasoning that applies to allocation among the functions applies to allocation among sub-functions. Here, where there are no direct labor ratios available due to Transco's current accounting practices,

the Commission concurs with the ALJ that plant ratios is an acceptable surrogate for the full application of the K-N methodology. As noted above, the Commission is herein directing Transco to account for costs incurred by the separate sub-functions as is required by the Commission's policy and regulations, and to utilize that accounting method for its next Section 4 rate case.

### J. The Allocation of A&G Costs to Transco's LNG Service

204. This issue involves the allocation of A&G costs among functions Transco's system, particularly to Transco's LNG service. Transco currently allocates A&G costs among its basic functions based on the K-N methodology, with two exceptions. When figuring the allocation to LNG customers, Transco (1) eliminates seven of the eleven accounts in which Transco records its A&G costs accounts from the allocation process,[47] and (2) Transco does not include all the associated labor costs of one of the remaining accounts. These modifications reduce the A&G costs that would otherwise be allocated to LNG service.

205. The ALJ found that A&G costs should be allocated to all of Transco's services, including the LNG services, consistent with the K-N method as advocated by Staff. Staff argued that Transco unfairly excludes some A&G accounts from the allocation process and modifies the direct labor allocation factor resulting in under-allocation of A&G costs to the LNG services. This under-allocation of costs to the LNG services results in a $2.1 million subsidization of LNG services by general system customers, according to Staff. Staff maintained that, since A&G costs are not related to the level of use of facilities, there is no justification for using relative operating costs as the basis to alter the allocation of A&G costs.

206. Transco and NUI argued that the existing practice has been found to be just and reasonable for over thirty years, and Staff has not met its burden of proof to show that the practice is no longer just and reasonable.

207. The ALJ reasoned that, because A&G are indirect costs which cannot be identified with specific customers, it is assumed that all classes of customers benefit from the incurrence of those costs, and all customers should pay those costs. The ALJ stated that no party has alleged that the LNG customers derive no benefit from the services

[47] The excluded costs include outside services employed, administrative and general salaries, regulatory commission expenses, miscellaneous general expenses, and maintenance of general plant and rents.

associated with the costs that have been excluded from allocation to the LNG customers. The ALJ found that Staff has demonstrated that excluding certain A&G costs from cost allocation to LNG customers results in a $2.1 million subsidy of LNG customers by other system customers.

208. On exceptions, Transco argues that this practice has been in effect and has been found to be just and reasonable since the inception of its LNG service in 1970. Transco contends that Staff has not met its burden to show that the practice is no longer just and reasonable. Staff bases its case on the need for consistency with the K-N method for allocating A&G costs among customers. Transco argues that the ALJ used circular reasoning in agreeing with Staff's position, i.e., the existing method of allocating A&G costs to LNG customers is inconsistent with K-N, and therefore, it is unjust and unreasonable because it is inconsistent with K-N.

209. In its brief opposing exceptions, Staff contends that the ALJ correctly found that Transco should allocate A&G costs to all customers based on the unaltered K-N methodology. Staff argues that LNG customers benefit from the costs incurred and should therefore bear a fair share of those costs. Staff stated that, although the current method has been in effect for over thirty years, it is now time to take a closer look at the proper allocation of those costs.

**Commission Decision**

210. For the reasons stated in the initial decision, the Commission affirms the ALJ on this issue. Since restructuring under Order No. 636 there has been increasing emphasis on competition and market forces as determinants of the services that are preferred. Competition works best where the prices for competitive services are accurate reflections of the costs associated with providing those services. This is not always possible. However, where costs have been accounted for so that they can be assigned to identifiable services, those costs should be so assigned to reflect, as much as possible, the true cost of providing that service. Here, Transco can identify the functions which incurred specific costs, but then makes downward adjustments to those costs associated with the LNG service. However, Transco has presented no reason to believe that LNG service does not benefit from the excluded costs, such as Commission regulatory expenses, general salaries, and maintenance of general plant and rent. Thus exclusion of these costs causes a break in the link between cost incurrence and cost responsibility, and results in a price for a service that may not be indicative of the cost of providing that service. For that reason, the Commission affirms the ALJ on this issue.

**K**. **Credits for Use of Right of Way for Fiber Optics**

211. The issue before the ALJ was whether Transco should credit its existing customers with a value for service provided to its then-affiliate, Williams Communications Company (WCC, formerly Vyvx), for the cost-free access to Transco's existing jurisdictional assets, and whether such an agreement should result in a rate credit to existing customers. Transco entered into an agreement with WCC under which Transco would not object to WCC's seeking from landowners easements to install a fiber optic system over some of the same land for which Transco already held easements for its pipeline. The relevant portions of Transco's pipeline at issue here run between Houston, TX and Philadelphia, PA, where Transco currently has a right-of-way (ROW) made up primarily of pipeline easements negotiated and purchased from third party landowners. Transco I.B. at 66; Ex. No. T-55 at 4; T-56. Under these easements, Transco is permitted only to install, operate and service its own pipelines, and nothing else. In its agreement with WCC, Transco would not object to WCC seeking its own ROW within the Transco pipeline ROW. In exchange, WCC gave Transco an indefeasible right of use (IRU) of two "dark" fibers in its new cable for Transco's telecommunications use in its jurisdictional operations. Ex. No. T-55 at 3-4; T-57.

212. Staff and Johns Hopkins University argued that the agreement was not an arm's length agreement since it was between affiliates, and they maintain that Transco's customers should be given a revenue credit for the transaction. Johns Hopkins maintained that since the agreement was not an arm's-length transaction it must be scrutinized under fair market standards. Johns Hopkins' analysis established the value of the right of way at $19.2 million and maintained that a $19.2 million credit to rate base is reasonable. Staff maintained that Transco's ratepayers are entitled to a revenue credit and established the value of the agreement at $4 million. Transco maintains that the transaction had no revenue impact whatsoever, and that neither party has carried its burden to show that such a revenue credit is warranted.

213. The ALJ found that Staff and Johns Hopkins did not meet their burden on this issue. The ALJ stated that he was convinced that Transco's ROW was exactly that, its ROW. The ALJ found that neither Staff nor Johns Hopkins offered convincing evidence otherwise, showing that somehow Transco gave its own existing ROW to WCC. The ALJ held that the evidence demonstrates that Transco agreed not to object when WCC sought to obtain its own ROW from customers along Transco's existing ROW. Ex. No. T-55 at 6; Ex. No. T-57 at 13-14; Tr. 1476, 1485, 1547-49. The ALJ acknowledged all the arguments that Johns Hopkins put forth that the agreement significantly benefited WCC. However, the ALJ stated that does not demonstrate that Transco's existing customers should receive a revenue credit or a reduction in rate base. The ALJ found that

nowhere in the record has Staff or Johns Hopkins demonstrated that existing customers have, in any way, specifically funded the arrangement between Transco and WCC.

214. Additionally, the ALJ found that Transco, in return for its agreement not to object, received two dark fibers in the exchange – a valuable asset, enhancing Transco's jurisdictional services. The ALJ stated that both Staff and Johns Hopkins have attempted to show that the cost of lighting these fibers - $4.6 million – is further evidence that this agreement was not a good one for Transco. However, the ALJ stated that the parties forget that these fibers are only used to support the functions of the pipeline, and, therefore, the related costs should be borne by rate payers. The initial decision stated that even in the event that Transco would have built the fiber optic system itself, the rate payers would bear that expense. Finally, the ALJ stated that although this does not appear to be an arm's-length transaction, neither Staff or Johns Hopkins has marshaled enough evidence to show that the agreement resulted in an unjust or unfair circumstance with the current ratepayers shouldering more of the cost than they should.

215. Briefs on exceptions were filed by Staff and Johns Hopkins. Staff asserts that the record in this case demonstrates that Transco entered into an arrangement with its affiliated telecommunications company that provided that affiliate with a right of way corridor (the costs of which were paid by jurisdictional ratepayers) for the purpose of installing fiber optic cable at very little cost and thereby put that affiliate in an advantageous position vis-à-vis its telecommunications competitors who had to pay much higher market costs to obtain comparable rights-of-way. Staff asserts that Transco's ratepayers are entitled to a $4 million cost of service credit representing 50 percent of the market value of the right-of-way conservatively calculated by Staff to be $8 million.

216. Johns Hopkins asserts that the initial decision fails to acknowledge that WCC could not have developed a fiber optic telecommunications network at all without Transco's active participation, irrespective of what it might have paid for its own easements. Johns Hopkins argues that the so-called benefits to customers found by the ALJ are wholly hypothetical and far more speculative as compared to the analyses performed by Johns Hopkins and Staff. Johns Hopkins asserts that jurisdictional pipelines should not be encouraged to enter into clandestine agreements involving the use of their assets, employees, and services to generate revenues from non-traditional businesses, which are neither disclosed to the Commission nor justified to their customers, nor should the results of such arrangements be condoned on the basis of a misplaced evidentiary standard. Johns Hopkins argues that jurisdictional pipelines should not be allowed to confer on their affiliates the commercial benefits of such arrangements. Johns Hopkins contends that customers should not be burdened with the task of discovering such arrangements and independently proving the terms of arm's length negotiations that in fact never took place in determining how such arrangement

would be carried out. Johns Hopkins asserts that the Commission should reverse the initial decision and provide an appropriate remedy to Transco's ratepayers.

217. In its brief opposing exceptions, Transco asserts that the decision correctly rejected the proposed credit to rate base or cost of service relating to Transco's not objecting to the laying of a fiber optic cable on portions of its right of way in exchange for fiber use in its operations.

**Commission Decision**

218. The arguments posed by Staff and Johns Hopkins requesting a cost of service or rate base credit are premised on the assumption that Transco is renting or leasing a jurisdictional asset, i.e., the pipeline's right of way, and since ratepayers are paying for such asset in their rates they are entitled an offsetting credit for the money received by Transco. However, as the ALJ has found and the evidence shows, Transco is not renting or leasing its pipeline right of way. The agreement between Transco and WCC was that Transco would not object to WCC obtaining its own right of way from landowners along the route of Transco's right of way. For its agreement, Transco received the use of fiber optics which it was able to use in its jurisdictional business to upgrade its communications network and thus provide a benefit to its customers. While it is true that the transaction is between affiliates and that it may have been an important factor in allowing WCC to go forward in the communications business, there is no showing that the assets paid for by ratepayers, namely Transco's easement for installing and operating a pipeline, are being used which would warrant a credit. In fact, as the ALJ found, Transco's customer received a tangible benefit because of the fiber optics which improved Transco's pipeline communications system. Accordingly, the Commission affirms the ALJ's decision.

The Commission orders:

(A) The initial decision is affirmed, in part, and reversed, in part, as discussed above.

(B) Within 30 days of the date of this order, Transco is directed to submit a filing to comply with the directives in this order.

By the Commission. Commissioner Kelly not participating.

( S E A L )

Linda Mitry,
Acting Secretary.