116 FERC ¶ 61, 074
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Empire State Pipeline and
Empire Pipeline, Inc.

Docket Nos. CP06-5-000
CP06-6-000
CP06-7-000

PRELIMINARY DETERMINATION ON NON-ENVIRONMENTAL ISSUES

(Issued July 20, 2006)

1. On October 11, 2005, Empire State Pipeline (Empire), a company that is exempt from the Commission's jurisdiction under section 1(c) of the Natural Gas Act (NGA), and Empire Pipeline, Inc. (EPI), a newly formed company with no pipeline facilities, filed a joint application, as supplemented,[1] under section 7(c) of the NGA for a certificate of public convenience and necessity authorizing the construction of pipeline facilities to connect Empire's existing non-jurisdictional system to Millennium Pipeline Company, L.L.C.'s (Millennium) proposed system. EPI also requests authorization under section 7(c) to operate the facilities to be constructed, together with Empire's existing system, as a jurisdictional interstate pipeline. Finally, EPI requests authority under section 7(c) to provide open-access firm and interruptible transportation service under Subpart G of Part 284 of the regulations and for a blanket construction certificate under Subpart F of Part 157 of the regulations.

2. In this order, the Commission makes a preliminary determination that the authorizations requested in this proceeding, subject to the conditions discussed herein, are in the public interest. While our findings here support issuance of the requested authorizations, this order does not consider or evaluate any of the environmental issues in this proceeding. These issues are still pending and will be addressed in a subsequent order when the environmental review and analysis are complete. Thus, final approval of the proposals herein is dependent on a favorable environmental review and nothing in this order limits our actions regarding the environmental analysis.

[1] The application was supplemented on March 2, 2006.

I. Background

A. Empire and EPI

3. Empire consists of a 24-inch diameter natural gas pipeline that extends approximately 157 miles from an interconnect with TransCanada PipeLines, Ltd. (TransCanada) at the United States-Canada border near Chippawa, Ontario to a terminus near Syracuse, New York. Empire was constructed under a certificate issued by the New York State Public Service Commission (New York PSC). Currently, Empire provides firm and interruptible transportation services to utilities, power producers, industrial companies, marketers, and other shippers under rates, terms, and conditions regulated by the New York PSC. Empire has a capacity of 556,207 Dth per day.

4. Empire is a Hinshaw pipeline exempt from the Commission's jurisdiction under section 1(c) of the NGA.[2] In addition to the interconnect with TransCanada, Empire interconnects with two interstate pipelines – National Fuel Gas Supply Corporation (National Fuel) and Dominion Transmission, Inc. (Dominion). Empire transports gas for National Fuel and Dominion under a blanket certificate issued pursuant to section 284.224 of the regulations.[3] The Commission also authorized Empire to construct and operate facilities at the border between the United States and Canada under section 3 of the NGA.[4]

5. Empire is a joint venture between Empire State Pipeline Company, LLC (Empire LLC) and St. Clair Pipeline Company, LLC (St. Clair LLC).[5] Empire LLC and St. Clair LLC own the Empire facilities as tenants in common. In 2003, National Fuel Gas Company (NFG) acquired control of Empire LLC and St. Clair LLC.

6. EPI is a newly formed company with no pipeline facilities. It is a wholly owned subsidiary of NFG. When the proposed facilities are constructed, Empire LLC and St.

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[2] *Empire State Pipeline*, 56 FERC ¶ 61,050 (1991). Section 1(c), also known as the Hinshaw amendment, allows a pipeline, like Empire, located wholly within one state to engage in interstate commerce without becoming subject to the Commission's jurisdiction, if the pipeline's rates, services, and facilities are regulated by the state and the gas is consumed within that state.

[3] *Empire State Pipeline*, 70 FERC ¶ 61,162 (1995).

[4] *Empire*, 56 FERC at 61,168 (1991).

[5] Empire LLC and St. Clair LLC are New York limited liability companies.

Clair LLC will merge into EPI in accordance with New York law. Effective with the merger, EPI will be vested with all of the property, assets, debts, obligations, and liabilities previously belonging to Empire LLC and St. Clair LLC, including ownership of the Empire facilities. Thus, EPI will hold the certificates issued in this proceeding.

B. The Millennium Project

7. In 2002, we authorized Millennium to construct and operate 424 miles of pipeline extending from an interconnection with TransCanada at the United States-Canada border to an interconnection with Consolidated Edison Company of New York, Inc. (Consolidated Edison) in Mount Vernon, New York, for service to New York City.[6] In a companion proposal, we authorized Columbia Gas Transmission Corporation (Columbia) to abandon facilities in New York and to lease capacity on Millennium's authorized facilities to transport gas to its customers.[7] The Millennium pipeline was never constructed because the New York Department of State (New York DOS) found that Millennium's proposals were inconsistent with New York's Coastal Management Program. Under the Federal Coastal Zone Management Act, Millennium appealed the New York DOS' denial to the Secretary of Commerce. The Secretary of Commerce denied Millennium's appeal and Millennium appealed the denial to the United States District Court for the District of Columbia. The court denied Millennium's appeal.[8]

8. Millennium now proposes to amend the project approved in 2002 to reduce the number of miles of facilities it proposes to construct in order to transport gas for Consolidated Edison, KeySpan Gas East Corporation d/b/a KeySpan Energy Delivery Long Island (KeySpan), and other shippers and to vacate a portion of the 2002 Order. Specifically, in Docket Nos. CP98-150-006, CP98-150-007, and CP98-150-008, Millennium proposes to acquire, construct, and operate approximately 228.7 miles of

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[6] *Millennium Pipeline Co.*, 97 FERC ¶ 61,292 (2001); *order issuing certificate and granting and denying requests for rehearing and clarification*, 100 FERC ¶ 61,277 (2002); *appeal pending*, *Town of Cortland v. FERC*, No. 02-1331, *et al.* (D.C. Cir.).

[7] *Id*.

[8] *Millennium Pipeline Co. v. Gutierrez*, No. 04-233, 2006 U.S. Dist. LEXIS 14273 (D.C. Cir. March 31, 2006).

pipeline extending from Greenwood east to Buena Vista, New York.[9] In addition, Millennium requests that the Commission vacate that portion of the 2002 Order that authorized it to construct approximately 200 miles of pipeline in western New York and to construct facilities from Buena Vista to Mount Vernon in eastern New York. Rather, Millennium will rely on Empire's existing facilities and EPI's proposed facilities to transport gas from the United States-Canada border to a connection with Millennium. In the east, Millennium will connect with Algonquin Gas Transmission, LLC (Algonquin), an interstate pipeline,[10] at Ramapo, New York, and with Orange and Rockland Utilities, Inc., New York State Electric & Gas Corporation (NYSEG), and Central Hudson Gas & Electric Corporation.[11]

II. Proposals

9. EPI requests authority to construct and operate a pipeline segment, known as the Empire connector facilities, from Empire's existing system to Millennium's proposed system. EPI also requests authority to operate Empire's existing pipeline as a jurisdictional interstate pipeline. In addition, EPI proposes to transport gas on the existing Empire pipeline and the proposed Empire connector facilities from Canada to Millennium. EPI proposes to charge separate rates for service to Empire's current customers on the existing pipeline and to customers on the proposed connector facilities. EPI submitted a *pro forma* tariff for service on the existing facilities and on the proposed Empire connector facilities. The proposals are described in more detail below.

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[9] Millennium filed the amendment in Docket No. CP98-150-006 on August 1, 2005, the amendment in Docket No. CP98-150-007 on December 20, 2005, and the amendment in Docket No. CP98-150-008 on May 3, 2006. On August 1, 2005 and May 3, 2006, in Docket Nos. CP98-151-003 and CP98-151-004, respectively, Columbia filed to amend the authorization it received in the 2002 order. These applications are pending before the Commission.

[10] In Docket No. CP06-76-000, Algonquin filed an application proposing to add compression at five compressor stations on its system and to construct and operate pipeline facilities in order to move gas for Millennium from Ramapo to a connection with Iroquois Gas Transmission System, L.P. (Iroquois) at Brookfield, Connecticut. In Docket No. CP02-31-002, Iroquois proposes to construct and operate a compressor station and cooling facilities to move gas to Consolidated Edison's facilities at Hunts Point in the Bronx, New York.

[11] Orange and Rockland, NYSEG, and Central Hudson are local distribution companies (LDC) that are regulated by the New York PSC.

A. Facilities

10. EPI proposes to construct a 78-mile long, 24-inch diameter pipeline from Victor, New York to a connection with Millennium near Corning, New York. (Victor is approximately 60 miles west of Empire's terminus.) The proposed pipeline will traverse the Finger Lakes region of New York through Ontario, Yates, Schuyler, Chemung, and Steuben Counties. The Empire connector facilities will have a design capacity of 250,000 Dth per day in the winter (November through March) and 221,100 Dth per day in the summer (April through October), and a maximum allowable operating pressure of 1,440 psig.

11. The current maximum allowable operating pressure on Empire's pipeline is reduced from 1,440 to 1,000 psig at a pressure reduction station near Victor. To transport gas to Millennium, the connector facilities must be tied into the higher-pressure section of Empire's pipeline. Due to space limitations at the pressure reduction station and areas immediately to the east of the station, EPI states that it can not tie the connector facilities to the existing pipeline at the pressure reduction station or construct a line paralleling the existing line. Thus, EPI proposes to move the pressure reduction station 1.2 miles east and replace the existing 1,000 psig pipe along this 1.2 mile segment with new pipe rated at 1,440 psig for transportation at the higher pressure on the Empire connector facilities.

12. EPI also proposes to construct a 20,620 horsepower compressor station, known as the Oakfield compressor station, at milepost 47 on Empire's existing pipeline near Oakfield, New York. The proposed Oakfield compressor station will be west of Victor, approximately midway between Chippawa and Rochester, New York. The compressor station will consist of two centrifugal turbine-driven compressor units each rated at approximately 10,310 horsepower, and will be connected to the existing pipeline through short sections of suction and discharge pipelines.[12]

13. Starting on the in-service date of proposed connector facilities, EPI requests authority to operate the existing 157-mile long Empire system as a jurisdictional pipeline under the NGA.

14. Upon the in-service date of the connection facilities, Empire LLC and St. Clair LLC, the owners of Empire's facilities, will merge into EPI. Thus, effective on that date, EPI requests authorization to operate as an interstate natural gas company in order to

[12] EPI states that it will also construct auxiliary facilities such as valves, drips, pig launchers and receivers, cathodic protection equipment, yard and station piping, electrical and communication equipment, and buildings under section 2.55 of the regulations. There are no non-jurisdictional facilities associated with this project.

transport gas in interstate commerce. Also, on that date, Empire requests that the Commission terminate the section 284.224 blanket certificate.

15. EPI states that it entered into a precedent agreement with KeySpan to transport 150,750 Dth of gas per day on a firm basis from a connection with TransCanada at the United States-Canada border to a connection with Millennium's proposed pipeline at Corning for a primary term of 10 years. This represents approximately 60.3 percent of the winter capacity and 68.2 percent of the summer capacity of the Empire connector project.

16. Between February 12 and March 29, 2005, Empire states that it held an open season to obtain requests from other shippers for the remaining firm transportation capacity on the Empire connector project (*i.e.*, 99,250 Dth per day in the winter and 70,350 Dth per day in the summer). Empire did not receive any other requests for service during the open season, but Empire states that it will continue to market its available project capacity during the pendency of this proceeding. In addition, between March 14 and March 29, 2005, Empire solicited offers from its existing shippers for the turn back of capacity that would enable EPI to reduce the size of the proposed Oakfield compressor station.[13]

17. Empire and EPI estimate that the cost of the Empire connector project will be $144.2 million. They anticipate that corporate funds from NFG will be used to finance the proposed facilities.

B. Rates

18. EPI proposes to establish separate firm, interruptible, and overrun rates for the existing and connector facilities based on the respective cost of service and billing determinants for service using the existing Empire facilities and for service on the proposed connector facilities. For each segment, EPI proposes year-round service and seasonal rates based on the winter and summer period for shippers who do not take service on a year-round basis. The rates for each segment are described below.

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[13] Empire received a response to its solicitation from United States Gypsum Corporation offering to turn back 2,000 Dth per day of capacity. Empire determined that a 2,000 Dth per day reduction in the required delivery capacity of the Oakfield station would not change the station's configuration or reduce Empire's capital expenditures. Also, Empire determined that its agreement with United States Gypsum would expire prior to the anticipated in-service date of the proposed facilities.

1. Empire's Existing System

19. EPI proposes annual and seasonal firm rates for Empire's existing shippers and other shippers with primary delivery points on the existing pipeline. EPI proposes to charge an initial recourse rate of $7.45 per Dth for year-round service and seasonal rates, with a winter rate of $10.728 per Dth and a summer rate of $5.0186 per Dth, for the shippers that do not take service on a year-round basis. EPI also proposes interruptible and overrun services for the winter and summer periods, based on a 100 percent load factor equivalent of the respective maximum reservation rate for the winter and summer periods.[14]

20. EPI states that the recourse rate is based on an estimated annual cost of service of $41,936,427 and billing determinates of 409,201 Dth per day. The proposed annual cost of service includes: (1) operation and maintenances (O&M) expenses of $5,195,233; (2) depreciation expense of $8,950,109, which is based on a four percent straight-line depreciation rate; (3) taxes other than income of $5,362,308; (4) amortization of tax deferral of $1,161,936; (5) federal and state income taxes of $6,794,699; and (6) return allowance of $14,663,159, based on a rate base of $142,637,738. EPI proposes a capital structure of 52.86 percent equity and 47.14 percent debt; a 14 percent equity return; a 6.65 percent cost of long-term debt and a 2.17 percent cost of short-term debt, with an overall return of 10.28 percent. EPI proposes that firm shippers on the existing pipeline will have access to secondary points on the connector facilities. Thus, EPI proposes a secondary point commodity surcharge designed to recover the difference between the applicable maximum reservation rates for the connector and existing systems on a unit rate basis.[15]

2. The Empire Connector Facilities

21. EPI proposes an initial recourse reservation rate of $10.8495 per Dth for annual firm service to Corning, or other points off the Empire connector facilities that may be established in the future. EPI also proposes seasonal rates on the connector facilities, with a $14.5698 per Dth winter rate and a $7.8449 per Dth summer rate. EPI states that the recourse rate is based on an estimated annual cost of service of approximately $30.4 million and billing determinants on an annual basis of 233,142 Dth per day, with

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[14] The proposed overrun and interruptible rates on the existing Empire pipeline are $0.3527 per Dth for the winter and $0.1680 per Dth for the summer period.

[15] The proposed secondary point commodity rates on the existing Empire pipeline are $0.1118 per Dth on an annual basis, $0.1263 per Dth for the winter period, and $0.09699 per Dth for the summer period.

250,000 Dth per day for the winter period and 221,100 Dth per day during the summer period. The annual cost of service is based on the same proposed rates of return and capital structure as the rates proposed for the existing facilities. However, the proposed cost of service for the connector facilities uses a 2.5 percent straight-line depreciation rate, rather than a four percent rate. The annual cost of service includes (1) O&M expenses of $754,567; (2) depreciation expense of $3,605,725; (3) taxes other than income of $4,326,870; (4) interest expense of $4,091,683; (5) return on equity of $10,513,352, based on a rate base of $142,072,326; and (6) federal and state taxes of $7,061,519. EPI proposes a capital structure similar to the existing pipeline with a 52.85 percent equity and 47.15 debt; a 14 percent return on equity; and a 6.65 percent cost of long-term debt and a 2.17 percent cost of short-term debt, with an overall return of 10.28 percent. EPI contends that the only variable cost will be fuel for the Oakfield compressor station, which it proposes to recover on an in-kind basis through a fuel tracker mechanism. Thus, EPI proposes an initial commodity rate of $0.00.

22. EPI states that the proposed incremental rates for the Empire connector facilities are based on the cost of those facilities, as well as the costs associated with the Oakfield compressor station, which will create the incremental capacity on the existing pipeline for the transportation of gas for connector facility shippers. As such, although shippers on the connector facilities will move gas on the existing pipeline segment, EPI states that rates for the connector facilities will not include the cost of transportation on the existing pipeline, nor will the billing determinants for the connector shippers be included in the initial rates on Empire's existing pipeline.

23. EPI requests a predetermination that, absent material changes in facts and circumstances shown in a future rate case, the rates applicable to its expansion shippers will not bear any portion of the costs associated with Empire's existing system, unless the Commission establishes fully rolled-in rates. EPI alleges that the predetermination is necessary because incrementally designed initial rates are fundamental to its ability to obtain parent company financing. EPI asserts that a shift in rate design in a future rate case would undercut the financial basis behind its investment in infrastructure.

3. Negotiated Rates

24. EPI's proposed tariff allows it to enter into negotiated rate transactions consistent with Commission policy. EPI proposes to charge, as negotiated rates, the rates Empire currently charges its existing shippers – NYSEG, Rochester Gas and Electric Corporation

(RG&E),[16] and Sithe/Independence Power Partners, L.P. (Sithe).[17] EPI also proposes to charge, as negotiated rates, the rates it has agreed to charge KeySpan. The tariff includes language allowing EPI to seek discount-type adjustments in future rate proceedings with respect to negotiated rates that were converted from existing discount services.

C. Services

25. Currently, Empire provides transportation service under the rates, terms, and conditions in a tariff approved by the New York PSC. This tariff permits Empire to provide firm and interruptible transportation, off-peak firm transportation, and peak firm transportation under separate rate schedules. The tariff also includes a form of service agreement applicable to all four services (*i.e.*, the New York *pro forma* service agreement).

26. EPI asserts that the existing Empire agreements consist of four longer-term firm agreements with anchor shippers, that made construction of Empire possible in 1993, and three shorter-term firm agreements that were more recently executed.[18] The longer-term anchor agreements have the following quantities and terms:

Existing Shipper	Dth per Day	Term
National Fuel Gas Distribution Corporation	40,112	March 15, 1994 to October 31, 2014
NYSEG	20,000	August 31, 1993 to October 31, 2008
RG&E	172,500	November 1, 1993 to October 31, 2008

[16] RG&E is a local distribution company regulated by the New York PSC that purchases, distributes, and sells natural gas.

[17] Sithe owns and operates a 1,060 net megawatt electric generation plant in Seneca, New York.

[18] The shorter-term firm agreements will also include any agreements entered into between the date the application was filed herein and the in-service date for the connector project for terms that extend beyond the in-service date.

Sithe	185,557	October 4, 1993 to December 31, 2014[19]

27. EPI states that it will provide service to new shippers under the form of service agreement in the proposed tariff, while continuing to provide service to Empire's existing shippers using the New York *pro forma* service agreement. EPI contends that this would not be unduly discriminatory because there is no "material difference" between the New York *pro forma* service agreement and its proposed form of service agreement. EPI states that it included the New York *pro forma* service agreement in its proposed tariff to obviate the need for it to seek approval of each existing agreement as a non-conforming agreement. EPI states that Empire's existing shippers will have the opportunity to enter into replacement agreements under EPI's proposed tariff and that its request covers only the shippers that want to continue service under their existing agreements with Empire.

28. EPI also requests that the Commission approve a non-conforming provision in its service agreement with KeySpan, which states, in part, that:

> The parties acknowledge that, as of the date of execution of this agreement, only a *pro forma* version of [EPI's] FERC gas tariff has been filed with the Commission and that transporter's formal tariff filing will occur prior to the date service is expected to commence under this agreement. Notwithstanding the fact that [EPI's] FERC Gas Tariff is not in effect as of the date of execution, the obligations of the parties set forth in this agreement are binding. To the extent that this agreement deviates from the form of service agreement appearing in [EPI's] FERC Gas tariff, as accepted by the Commission, in a manner deemed impermissible by the Commission, the parties agree to amend this agreement to remove any such impermissible deviations.

D. **Subpart F Blanket Certificate**

29. EPI requests a blanket certificate under Subpart F of Part 157 in order to undertake certain routine construction, maintenance, and operational activities related to its proposals.

[19] EPI states that it will terminate Empire's interruptible service agreements after 30 days notice on the in-service date of the connector facilities and offer these shippers new interruptible agreements under its proposed Commission tariff. Currently, Empire does not have peak or off-peak firm shippers.

E. Subpart G Blanket Certificate

30. EPI requests a blanket certificate under Subpart G of Part 284 in order to provide firm and interruptible transportation services for its customers. EPI states that all of its shippers including shippers taking service made possible by the proposed connector facilities, new shippers using capacity on Empire's existing system, and Empire's existing shippers will receive service under the Part 284 blanket certificate. [20]

F. Request for Waivers

31. EPI requests a waiver of the shipper must hold title policy to enable it to acquire capacity on other transmission systems. EPI also requests a waiver of section 284.286 of the regulations to enable it to engage in operational purchases and sales of gas without establishing an independent sales operating unit.

G. Justification for Proposals

32. EPI asserts that its proposed facilities will provide access to Canadian and domestic gas supplies at the United States-Canada border, the Dawn, Ontario hub, and other upstream trading points. In addition, EPI points out that Empire's existing pipeline interconnects with National Fuel and Dominion, which will provide EPI's customers access to storage facilities in western New York and northwestern Pennsylvania.

33. EPI also contends that the Empire connector project is necessary to meet power generation needs in New York. To support its assertion, EPI cites a January 2004 report by the New York City Energy Policy Task Force, an April 2005 report by the New York Independent System Operator, and two reports by the Commission's staff. Specifically, EPI states that the New York City Task Force report recommended the development of additional interstate pipeline and gas supply projects in the metropolitan area to "enhance reliability, increase diversity, and reduce price volatility."[21] EPI asserts that the New York Independent System Operator report found that current gas pipeline infrastructure may not always permit deliverability of the large amounts of gas needed for electric generation if demand is high and concludes that additional pipeline infrastructure will be

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[20] As of the in-service date of the connector facilities, EPI states that several firm transportation service agreements entered into between Empire and its shippers, while Empire was subject to the jurisdiction of the New York PSC, will remain in effect.

[21] *New York City Energy Policy: An Electricity Resource Roadmap,* New York City Energy Policy Task Force (January 2004).

needed for electric generation.[22] EPI also contends that the Commission's staff reports found uncertainty regarding pipeline capacity and gas supply to meet the needs of the northeast market.[23]

34. In addition, EPI cites an Energy Information Administration[24] report that predicts residential, commercial, and industrial gas consumption will increase in the northeast and market studies by Islander East Pipeline Company LLC (Islander East)[25] and KeySpan Corporation,[26] showing the opportunity for growth in gas consumption in the Long Island residential market.

35. Finally, EPI contends that the supply flexibility provided by its proposed connector project should result in more price competition and potentially reduce price volatility in the New York and Long Island markets by offering more access to existing and new gas supply sources.

36. For these reasons, EPI concludes that the Empire connector project will serve the growing needs of the New York City and Long Island regions. EPI also contends that its proposals will add pipeline capacity, increase deliverability for electric generation and local distribution company growth, enhance gas supply and storage options to these markets as well as to existing customers, and enhance the region's potential for price stability.

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[22] *ISO Power Trends 2005: A Report by the New York Independent System Operator* (April 2005).

[23] *2004/05 Winter Energy Market Assessment*, Office of Market Oversight and Investigations, Federal Energy Regulatory Commission (November 18, 2004); *New England Natural Gas Infrastructure*, Staff Report of the Federal Energy Regulatory Commission, Docket No. PL04-1-000 (December 2003).

[24] Energy Information Administration's Annual Energy Outlook 2005.

[25] Islander East market study in Docket No. CP01-384-000 filed June 15, 2001.

[26] KeySpan Corporation's 2004 Annual Report.

III. Interventions

37. Notice of Empire's and EPI's application was published in the *Federal Register* on December 7, 2005 (70 *Fed. Reg.* 72808). Algonquin; the City of New York, New York; the KeySpan Delivery Companies;[27] National Fuel Gas Distribution Corporation (National Fuel Distribution); and Sithe filed timely, unopposed motions to intervene.[28] In addition, the NYSEG and RG&E filed a timely, unopposed, joint motion to intervene. The New York PSC filed a notice of intervention.

38. Millennium and Amerada Hess Corporation (Amerada Hess) filed untimely motions to intervene. Alicia Leppert and William Taylor filed an untimely, joint motion to intervene. Millennium, Amerada Hess, and Alicia Leppert and William Taylor have demonstrated an interest in this proceeding and have shown good cause for intervening out of time. Further, the untimely motions will not delay, disrupt, or otherwise prejudice this proceeding. Thus, we will grant Millennium's, Amerada Hess', and Alicia Leppert's and William Taylor's untimely motions to intervene.

39. The motions to intervene of Amerada Hess, National Fuel Distribution, the New York PSC, and Sithe included protests. NYSEG's and RG&E's joint motion included comments to the application. The Ontario Country, New York Board of Supervisors filed comments supporting the application. Empire and EPI filed a joint answer to the protests and comments of the interveners. National Fuel Distribution, NYSEG and RG&E, the New York PSC, and Sithe filed answers to Empire's and EPI's answer. Empire and EPI filed an answer to National Fuel Distribution's answer and an answer to Sithe's and NYSEG's and RG&E's answer.

40. Answers to protests and answers to answers are not allowed under our rules.[29] Nevertheless, we will accept all of Empire's and EPI's answers to the protests and comments and National Fuel Distribution's, NYSEG's and RG&E's, the New York PSC's, and Sithe's answers because these pleadings provided information that assisted us in our decision making.

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[27] The KeySpan Delivery Companies consist of KeySpan Energy Delivery New York, KeySpan Energy Delivery Long Island, Boston Gas Company, Colonial Gas Company, EnergyNorth Natural Gas, Inc., and Essex Gas Company.

[28] Timely, unopposed motions to intervene are granted by operation of Rule 214.

[29] 18 C.F.R. § 385.213(a)(2) (2005).

IV. Procedural Matters

41. In the application, EPI requested confidential treatment for its negotiated rate agreement with KeySpan, the negotiated rate agreements between Empire and some of its existing customers, and for the flow diagrams in Exhibits G, G-I, and G-II. On April 7, 2006, Sithe filed a request for a protective order so that it could review the documents for which EPI requested confidential treatment.

42. On April 26, 2006, we ordered Empire and EPI to enter into a protective agreement with Sithe within 10 days of the date of the order and to provide Sithe with the privileged information it requested.[30] Empire and EPI complied with the April 26 Order.

V. Discussion

43. Since the proposed facilities will be used to transport natural gas in interstate commerce subject to the jurisdiction of the Commission, the construction and operation of the facilities are subject to the requirements of subsections (c) and (e) of section 7 of the NGA.

A. Certificate Policy Statement

44. The Certificate Policy Statement provides guidance as to how we will evaluate proposals for certificating new construction.[31] The Certificate Policy Statement established criteria for determining whether there is a need for a proposed project and whether the proposed project will serve the public interest. The Certificate Policy Statement explained that in deciding whether to authorize the construction of major new pipeline facilities, we balance the public benefits against the potential adverse consequences. Our goal is to give appropriate consideration to the enhancement of competitive transportation alternatives, the possibility of overbuilding, subsidization by existing customers, the applicant's responsibility for unsubscribed capacity, the avoidance of unnecessary disruptions of the environment, and the unneeded exercise of eminent domain in evaluating new pipeline construction.

45. Under this policy, the threshold requirement for pipelines proposing new projects is that the pipeline must be prepared to financially support the project without relying on

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[30] *Empire State Pipeline*, 115 FERC ¶ 61,113 (2006).

[31] *Certification of New Interstate Natural Gas Pipeline Facilities* (Certificate Policy Statement), 88 FERC ¶ 61,227 (1999), *order clarifying statement of policy*, 90 FERC ¶ 61,128, *order further clarifying statement of policy*, 92 FERC ¶ 61,094 (2000).

subsidization from its existing customers. The next step is to determine whether the applicant has made efforts to eliminate or minimize any adverse effects the project might have on the applicant's existing customers, existing pipelines in the market and their captive customers, or landowners and communities affected by the route of the new pipeline. If residual adverse effects on these interest groups are identified after efforts have been made to minimize them, we will evaluate the project by balancing the evidence of public benefits to be achieved against the residual adverse effects. This is essentially an economic test. Only when the benefits outweigh the adverse effects on economic interests will we proceed to complete the environmental analysis where other interests are considered.

1. Subsidies

a. Pleadings

46. Sithe contends that the Empire connector project does not satisfy the no subsidy requirement in the Certificate Policy Statement because EPI has inflated the cost of service for the existing system in order to increase the initial recourse rates, while understating the incremental recourse rates. Sithe concludes that EPI is seeking to shift costs and risks to its existing system recourse ratepayers, since KeySpan, the only customer for the proposed project, will pay a negotiated rate.

47. EPI asserts that the proposed incremental recourse rates for shippers using the extension facilities prevent subsidization by existing shippers. EPI contends that the proposed incremental rate reflects the costs of expanding the capacity of the existing line, with the addition of the Oakfield compressor station and the replacement of 1.2 miles of pipeline east of the pressure reduction station, and the cost of constructing the extension facilities to Corning. EPI contends that the costs associated with the facilities necessary to transport gas on the existing facilities to Millennium are fully allocated to the Empire connector shippers.

b. Commission Holding

48. The threshold requirement is that the pipeline must be prepared to financially support the project without relying on subsidization from its existing customers. We find that the proposed incremental rate for the connector facilities is appropriately designed because the rate includes the costs associated with the Oakfield compressor station, which will create the incremental capacity on the existing pipeline for the transportation of gas for connector facility shippers, and the full cost of the facilities from Victor to

Corning. Since EPI is proposing incremental rates, the existing Empire customers cannot subsidize the project.[32] Thus, EPI's proposal meets the threshold test of the Certificate Policy Statement.

2. Existing Customers, Competing Pipelines, and Landowners

49. EPI's proposals will not result in the degradation of service to any of its existing customers. In addition, no service on any other pipeline will be displaced, since EPI's proposal is designed to serve new markets. Thus, there will not be any adverse effects on existing pipelines or their customers.

50. Under section 7(h) of the NGA, an applicant with a Commission-issued certificate has the right to exercise eminent domain to acquire the land necessary to construct and operate its proposed facilities, when it cannot reach a voluntary agreement with the landowner. Landowners whose land may be condemned have an interest in the applicant's proposals, as does the community near the right-of-way.[33] In our consideration of landowner and community interests under the Certificate Policy Statement, we seek to avoid unnecessary construction in order to minimize the applicant's power to condemn land to construct facilities under the eminent domain rights conveyed by the Commission's certificate.[34]

51. Here, approximately 50 percent of the proposed connector parallels existing pipeline, roadway, powerline, and current or former rail bed corridors. EPI alleges that it has identified 24 route variations that avoid unmapped Mennonite schools and churches, unmapped wetlands and other resources, agricultural tile systems, newly developed property, and other existing and future land uses. EPI asserts that it has contacted over 600 property owners along the proposed, or alternative, routes and obtained survey permission for approximately 98 percent of the corridor. EPI states that it has completed engineering, archaeological and biological studies, and wetland delineation along 80 percent of the route and that survey activities on the remaining accessible properties are ongoing. Thus, we find that any adverse impacts on landowners or communities near the proposed Empire connector project will be minimal.

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[32] *Natural Gas Pipeline Company of America*, 110 FERC ¶ 61,341 (2005); *Transcontinental Gas Pipe Line Corp.*, 92 FERC ¶ 61,285 (2000), *reh'g denied*, 95 FERC ¶ 61,426 (2001).

[33] Certificate Policy Statement, 88 FERC at 61,748.

[34] *Id*. *See also Order Clarifying Statement of Policy*, 90 FERC at 61,398.

3. Conclusion

52. The proposed Empire connector facilities will be the upstream supply link for the Millennium pipeline. As such, we find that the proposals will serve the growing natural gas markets in New York City and Long Island. We also find that the construction of the Empire connector project will add pipeline capacity and increase deliverability for electric generation and LDC growth, enhance natural gas supply and storage options to these markets and to existing customers, and enhance the region's potential for price stability. The proposed facilities will be constructed without subsidies. Finally, we find no identified adverse effect on existing customers, other pipelines, landowners, or communities. Thus, this order makes a preliminary determination, pending completion of the environmental review, that EPI's proposals herein are in the public convenience and necessity under section 7(c).

B. Rates

1. Rate Base Issues

a. Acquisition Adjustment

53. EPI seeks an adjustment to rate base in the amount of $36,120,986, which EPI states is a portion of the amount paid in excess of book value by NFG when it acquired control of Empire in 2003. EPI contends that it is aware of the Commission's original cost concept, which limits a pipeline to including no more than a facility's depreciated original cost in rate base. However, EPI asserts that it meets the requirements of an exception to the original cost policy established in *Longhorn*, because it will be subject to the Commission's jurisdiction for the first time and because the benefits to customers are substantial and can be quantified.[35]

54. EPI contends that the integration of the proposed expansion project with Empire's existing facilities will enhance system reliability for existing shippers. Further, EPI asserts that existing shippers will now have the ability to deliver gas to Millennium and to downstream markets in New York City and Long Island. EPI calculates $5.3 million in annual benefits for existing shippers who use the Millennium point on a secondary basis, or release their capacity to other shippers that use that point. EPI states that it calculated the benefits by (1) determining the amount of unused firm capacity under existing operations, based on an average of the results of the past two years; (2) estimating the extent to which that capacity could be used for delivery of gas into Millennium; and

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[35] *Longhorn Partners Pipeline, L.P.*, 82 FERC ¶ 61,146; *order on reh'g*, 85 FERC ¶ 61,207 (1998). *See also Longhorn Partners Pipeline, L.P.*, 73 FERC ¶ 61,355 (1995).

(3) estimating the value of the resulting capacity. According to EPI's calculations, it determined that the value of the secondary capacity would be $.05 per Dth in the summer and $.30 per Dth in the winter.

(1) Pleadings

55. Sithe contends that EPI failed to meet either prong of the *Longhorn* test because (1) the facilities are not being converted to a new use or placed in service for the first time, since the existing Empire facilities have operated for years under a blanket certificate as a Hinshaw pipeline; and (2) the benefits claimed by EPI are speculative and unreliable. Sithe also asserts that the purchase is tainted by the fact that NFG owned an interest in Empire prior to acquiring control in 2003, and now seeks to pass through to its existing customers the amount paid over book value for a pipeline in which NFG had an ownership interest, which is a practice contrary to Commission policy and precedent.[36]

56. Further, Sithe asserts that the $5.3 million in benefits claimed by EPI overstates the possibility of capacity release for existing shippers at Corning – the point the releases would need to reach to obtain the transportation values calculated by EPI. Sithe also avers that EPI's study fails to appropriately account for the secondary access surcharges that will be applied to capacity releases by existing shippers going to the Corning interconnection.

(2) Commission Holding

57. Our longstanding policy is to only allow the net book value of facilities in rate base for pipelines, such as EPI, which continue to provide regulated natural gas services. While there have been limited exceptions to that policy, a pipeline cannot, in most instances, recover a premium paid in excess of book value through its jurisdictional rates.[37]

58. In order to recover such a premium, we have held that the pipeline has "the burden of establishing the dollar amount of the benefits alleged to have conferred upon the consumers."[38] In fact, it is necessary "to establish not only what benefits were conferred

[36] *Citing Rio Grande Pipeline Co.*, 82 FERC ¶ 61,147 (1998).

[37] *Enbridge Pipelines*, 100 FERC ¶ 61,260 at P 48 (2002).

[38] *United Gas Pipeline Co.*, 25 F.P.C. 35 at 50-51(1960), *aff'd on the issue of acquisition premium*, 25 F.P.C. 26 (1961); *rev'd on other grounds sub nom. Willmut Gas and Oil Co. v. FPC*, 299 F.2d 111 (D.C. Cir. 1962).

on consumers by the making of the excess payments but to present evidence by which these alleged benefits could be measured in terms of such dollars."[39] Since the decision in *United*, we have considered other requests for acquisition premiums, including the *Longhorn* case cited by both EPI and Sithe. In all cases, however, we have required that pipelines must show quantifiable benefits to customers that result from the excess cost paid.

59. EPI contends that it meets the first prong of the *Longhorn* test because it is placing utility assets in jurisdictional service for the first time. However, EPI's existing facilities are already devoted to natural gas service and subject to our jurisdiction because of its acceptance of a blanket certificate under section 284.224.[40] Significantly, in a similar situation involving Enbridge Pipeline, an intrastate pipeline that became subject to our jurisdiction, we rejected Enbridge's assertion that the facilities were newly placed under the Commission's jurisdiction since the facilities had already been devoted to natural gas service.[41]

60. We also reject EPI's claim of substantial benefits, since it failed to demonstrate that the acquisition resulted in substantial and quantifiable benefits to its ratepayers. The $5.3 million in annual benefits to ratepayers claimed by EPI was based on the ability of shippers to deliver gas to Millennium and to serve downstream markets in New York City and Long Island. EPI calculated the alleged benefit by first determining the amount of contracted capacity that is not being used under existing operations, based on Empire's average results for the past two years. Then, EPI estimated the extent to which that capacity could be used to deliver gas to Millennium for the benefit of shippers serving downstream markets. EPI states that adjustments were made to reflect the limitations on its physical ability to redirect gas to Corning and to recognize that not all available capacity to Corning would be used each month. EPI states that it estimated the value of the remaining capacity, based on estimated basis differentials between Niagara and Leidy, Pennsylvania and determined that the value of secondary capacity would be $.05 per Dth in the summer and $.30 per Dth in the winter. EPI alleges that these figures reflect the increased value of gas in the New York City market over gas in markets served by existing pipelines.

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[39] *Id*.

[40] *National Fuel Gas Supply Corp., et al.*, 70 FERC ¶ 61,162 (1995). Empire is also subject to the Commission's authority since it was granted the authority to construct and operate natural gas facilities between the United States and Canada.

[41] *See Enbridge*, 100 FERC ¶ 61,260 at P 52 (2002).

61. EPI's claim of benefits is premised entirely on the ability of its existing customers, or shippers to whom they may release capacity, to move their gas to Millennium and realize the estimated gain calculated by EPI. We find that EPI's calculations for capacity release possibilities for existing shippers at Corning are overstated, since EPI fails to take into account the expansion capacity held by KeySpan, which is 150,750 Dth per day of firm capacity. Whether KeySpan uses or releases its capacity, it will have a higher priority than existing shippers on the expansion facilities. If other firm shippers contract for expansion capacity, they too will have higher priority rights to Corning than the existing shippers.

62. The commensurate benefits test requires that the benefits claimed be tangible, quantifiable, and directly attributable to the expansion.[42] EPI's alleged benefits are based wholly on speculation, and its calculation of future capacity release usage appears excessive. Further, the claim that existing shippers will have greater flexibility is not based on NFG's 2003 acquisition of ownership interests in Empire, but on the expansion. EPI has not shown that there is a quantifiable connection between NFG's 2003 acquisition and the benefits claimed to flow from the expansion. In *Enbridge*, we rejected a similar argument, finding that the acquisition of the facilities at issue was one of several transactions that "permitted expansion of the natural gas services of facilities already being used for natural gas service."[43] In sum, EPI has failed to demonstrate that the facilities provide a new service or, more importantly, provided evidence to show that there are tangible, quantifiable benefits to support the acquisition adjustment.

63. For these reasons, we find that EPI must remove the proposed $36,120,986 acquisition adjustment from rate base.

b. Adjustments to Plant Costs

64. EPI proposes plant costs of $142,637,738 for the existing pipeline and $142,072,326 for the connector facilities. EPI asserts that its proposed plant cost for the existing pipeline includes $12,799,796 for additions to the existing system plant prior to the projected in-service date of November 1, 2007. The additions include normal plant additions, class change-outs, installation of zinc cable, and testing stations for the existing zinc cable.[44]

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[42] *Id*. at P 53.

[43] *See Enbridge*, *supra*, at P 52. Empire's attempt to include the acquisition in its state-regulated rates was rejected by the New York PSC.

[44] *See* Exhibit N, Part 1, page 5.

(1) Pleadings

65. Sithe asserts that EPI failed to explain its proposal to increase existing system plant by approximately $12.8 million to reflect plant proposed to be added before November 1, 2007, nor why EPI deems it necessary to allocate these costs entirely to Empire's existing system rates.

(2) Commission Holding

66. In the affidavit of Ronald C. Kraemer,[45] EPI provides an explanation of the proposed $12.8 million addition in plant costs. According to Mr. Kraemer's testimony, the additions include: (1) routine capital expenditures for transmission and general plant; (2) class change-out areas along the existing pipeline that require replacement; and (3) significant costs to install zinc cable to prevent AC corrosion to over 73 miles of pipeline that is not now equipped with zinc ribbon.

67. Based on Mr. Kraemer's testimony and our review of these costs, we find that the proposed increased plant costs for the existing pipeline of $12.8 million are reasonable and necessary for the operation of the pipeline as of November 1, 2007. Further, since the proposed additions will help maintain service on the existing pipeline, the additions would have occurred regardless of the proposed connector facilities and would have been paid for by the existing customers. Thus, we will approve the proposed plant costs of $142,637,738 for the existing system, which does not include the acquisition adjustment discussed above and revises the cash working capital expense discussed below. We will also approve plant costs of $142,072,326 for the connector facilities, as adjusted for cash working capital discussed below.

c. Cash Working Capital

68. EPI proposes a cash working capital expense for the existing Empire pipeline of $514,430 and an expense of $1,802,863 for the connector facilities.

69. In its March 17 supplemental data response to question 7, EPI provided a detailed lead-lag study, which we require to support a working capital expense.[46] The lead-lag study shows that the working capital expense for the existing pipeline is $314,000, instead of the proposed $514,430, and that the working capital expense for the connector facilities is $1,514,405, instead of the proposed $1,802,863. Due to EPI's change in the working capital expense based on the lead-lag study, we will require EPI to revise its cost

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[45] *See* Affidavit of Ronald C. Kraemer, at p. 10 line 20 through p. 21 line 23.

[46] *See* section 154.312(e) of the regulations.

of service and rates to reflect the actual expense for working capital reported in the lead-lag study.

2. Cost of Service Issues

a. O&M Expense Adjustments

70. EPI proposes O&M expenses of $5,195,233 for the existing system and $754,567 for the proposed connector facilities. To derive the $5,195,233 O&M expense for the existing system, EPI determined the cost as of March 2005 and made various adjustments, including $464,303 for inflation, $363,890 for a business system conversion to meet Commission regulatory requirements, $200,000 for integrity management, and other expenses that EPI contends are known and measurable and that will be incurred on a recurring basis on or before the projected in-service date on November 1, 2007.

(1) Pleadings

71. Sithe asserts that EPI's proposed O&M expenses for the existing pipeline appear to be overstated, since administrative and general (A&G) expenses comprise over 60 percent of the existing system O&M costs and EPI will have only one full-time employee.

72. EPI admits that it only has one full-time employee, but asserts that National Fuel and National Fuel Distribution provide O&M services and a wide range of A&G services, including accounting, executive, financial planning, human resources, information, purchasing, and tax services.

(2) Commission Holding

73. We find that EPI has provided sufficient support for the proposed O&M expenses required to operate the existing pipeline, as well as the various projected adjustment costs. EPI has shown that although it has only one employee, its business functions are performed in large part by employees of National Fuel and National Fuel Distribution and has provided the O&M labor costs to support the proposed O&M expense, except for the inflation adjustment discussed below.[47] There is a concern, however, that the ratepayers for the existing pipeline should be protected from subsidizing the connector pipeline. To insure that subsidization does not occur, we will require EPI to isolate the costs for each segment, keeping separate books and records to insure that the customers for each segment will not subsidize the other system. Also, we will require EPI to

[47] *See* P 74-78 of the order.

maintain separate accounts for the existing and connector facilities, with applicable cross-references, as required by section 154.309 of the regulations. Parties can question the allocation of costs between the existing and connector facilities when EPI files its cost and revenue study or its section 4 rate case, which will be no later than three years after the in-service date. Further, as discussed below, we will require EPI to remove the $464,303 inflation adjustment from the O&M expenses. We will accept the proposed $754,567 O&M expense for the connector facilities.

b. Inflation Adjustment for O&M and A&G Expenses

74. EPI proposes a four percent inflation adjustment for three cost of service components – O&M expenses, A&G expenses, and taxes other than income for the existing and the connector facilities. For the existing facilities, EPI starts with a base period of 12 months of actual expenses ending March 31, 2005. EPI proposes to increase the base period actuals by a four percent per year inflation adjustment to derive the proposed expense for the November 1, 2007 in-service date.

(1) Pleadings

75. The New York PSC and NYSEG and RG&E contend that an inflation adjustment for the three cost of service components is contrary to Commission precedent and should be removed.

76. In a section 7 proceeding, EPI contends that the Commission has recognized the need to account for inflation in the establishment of initial rates from historic data filed with the certificate application.[48] EPI asserts that an inflation adjustment is appropriate here, considering the length of time required to obtain a certificate and construct the project. In addition, EPI alleges that the proposed four percent inflation adjustment is a reasonable estimate of O&M cost trends.[49]

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[48] EPI cites *Maritimes & Northeast Pipeline, L.L.C.*, 80 FERC ¶ 61,346 at 62,185 (1997).

[49] EPI cites the Bureau of Labor Statistics' (BLS) Consumer Price Index for all Urban Consumers (increase of 3.4 percent between December 2004 and December 2005), the BLS' Producer Price Index (increase of 5.4 percent for all finished goods between December 2004 and December 2005); and the Construction Cost Index as published by McGraw Hill's *Engineering News Record* (increase of five percent over one year).

(2) Commission Holding

77. In most initial rate proposals for new pipelines, there is an absence of actual expense data. Estimates are the only means available to generate proposed recoverable expenses. For the existing Empire facilities, however, the data does exist because the pipeline has been in service for more than 10 years.

78. Initial rate cost projections can be made many different ways, but they must be reasonable. EPI, however, does not make any attempt to demonstrate that its proposed inflation adjustment has any relevance or historic comparability to Empire's existing operating costs. In the alternative, EPI could have used the known and measurable standard in Part 154 of the regulations, which requires that to be recoverable, costs must be known and measurable with reasonable accuracy at the time of the filing to become effective within the adjustment period.[50] EPI did not provide such a cost item by cost item analysis. Traditionally, under Part 154 rate proceedings, costs based on projections regarding future inflation rates are contrary to our regulations requiring costs to be known and measurable to be recoverable.[51] Thus, we will require EPI to remove its inflation adjustment from O&M expenses, A&G expenses, and taxes other than income taxes for the cost of service for the existing pipeline.

c. Depreciation Rate

79. EPI proposes a four percent depreciation rate for the existing Empire system, which is the currently effective rate approved by the New York PSC, and a 2.5 percent depreciation rate for the proposed connector facilities.

(1) Pleadings

80. Sithe and the New York PSC note that Empire will have depreciated its existing system plant 56 percent as of November 1, 2007, after approximately 14 years of service. At a depreciation rate of four percent per year, Sithe asserts that would leave a remaining life of approximately 11 years for the existing system. Sithe avers that the 11-year remaining life does not match the 40-year life inherent in EPI's proposed 2.5 percent depreciation rate for the Empire connector project. Sithe and the New York PSC recommend that the Commission adopt a depreciation rate of 2.5 percent for the existing

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[50] 18 C.F.R. § 154.303(4) (2005).

[51] *Columbia Gulf Transmission Co.*, 67 FERC ¶ 61,242 at 61,802 (1994); *Williston Basin Interstate Pipeline Co.*, 56 FERC ¶ 61,360 at 61,371 (1991); *Transcontinental Gas Pipe Line Corp.*, 11 F.P.C. 94 at 106-07 (1952).

Empire system that matches the estimated useful life of EPI's proposed connector facilities, *i.e.*, 40 years.

81. EPI asserts that the depreciation rate for the existing system was always based on a 25-year life[52] and that there is no basis for disturbing its choice to use the straight-line depreciation method. EPI asserts that its proposed depreciation rates can be explored in the context of any proceeding initiated after it files a cost and revenue study after three years of operation and that it will maintain separate records for the plant associated with the existing and the expansion facilities.

(2) Commission Holding

82. The Uniform System of Accounts provides several different methods by which depreciation levels may be set including obsolescence, regulatory mandates, useful life and supply projections.[53] Instead, EPI's proposal is based on the depreciation levels permitted by the New York PSC. EPI makes no attempt to reconcile that depreciation level with the changed circumstances its proposed expansion and new markets imply with regard to depreciation.

83. We do not believe there are issues related to obsolescence or regulatory mandates that are quantifiable or knowable to the degree necessary to use them as a basis for establishing EPI's depreciation level. EPI's proposals are designed to provide the upstream link between Canadian gas supplies and Millennium, with gas being transported on Empire's existing system and the connector facilities to reach Millennium and eventually New York City. These two segments are interrelated and necessary components to provide the New York City market with additional access to Canadian supplies. Further, the existing facilities and the proposed connector facilities will remain in service to provide transportation for Canadian gas supplies, which EPI estimates will be available for 40 years based on a 2.5 percent depreciation rate. The depreciation rate for each segment should not be viewed in isolation when each facility is necessary to provide the proposed service. In the absence of any information to distinguish EPI's facilities for the purpose of establishing differing depreciation levels for each segment, we will require EPI to use the proposed 2.5 percent deprecation rate for the connector facilities to design rates for its entire system. Thus, we will require EPI to change the proposed four percent depreciation rate for the existing system to the system-wide rate of 2.5 percent.

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[52] During the first 10 years, EPI states that the rate varied from year to year in accordance with the "reverse sum of the years' digits method, but since year 10 the facilities have depreciated according to the straight-line method at four percent.

[53] *See* the definition section of Part 201 of the regulations.

d. Return on Equity

84. For the existing and proposed connector facilities, EPI proposes a 14 percent return on equity and a capital structure of 52.86 percent equity, 41.43 percent long-term debt, and 5.71 percent short-term debt. EPI claims that the proposed capital structure is based on National Fuel's capital structure, because National Fuel will finance the proposed connector facilities.

(1) Pleadings

85. Sithe and the New York PSC contend that EPI's request for a 14 percent return on equity is not appropriate because a 14 percent rate of return should be limited to the construction, start up, and financing of a new pipeline. Sithe asserts that EPI should not receive a higher return on equity as part of its system rates simply because it chose to expand its system and submit to full NGA jurisdiction. Sithe requests that the Commission (i) review Empire's New York PSC-approved rate of return to determine whether it is reasonable to use in establishing initial recourse rates for services on Empire's existing system; or (ii) perform a discounted cash flow study to determine an appropriate return on equity for use in establishing initial recourse rates for services on Empire's existing system.

86. EPI contends that the proposed 14 percent return on equity is justified by the significant business risks associated with Empire's existing system and by the fact that the Commission has consistently approved a 14 percent return on equity for new projects.[54] EPI points out that it has risk associated with RG&E's contract, which represents approximately 34 percent of Empire's existing capacity and revenue and expires in 2008, since RG&E has a pipeline alternative to EPI. In addition, EPI alleges that it has risk associated with Sithe's contract, which represents 36 percent of Empire's firm capacity and 42 percent of its revenues, since Sithe has recently realigned its gas supply portfolio resulting in a "mismatch" with upstream capacity. Also, EPI asserts that 11 percent of its existing revenue is derived from short-term contracts for which there are no assurances of renewal. Finally, EPI asserts that there is no basis to distinguish between Empire's existing system and the proposed facilities in assigning returns.

87. EPI also contends that the Commission should not treat the development of interstate gas pipeline facilities differently from the development of interstate electric

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[54] EPI cites *Dominion South Pipeline Co.*, 113 FERC ¶ 61,064 (2005); *Sabine Pass LNG, L.P.*, 109 FERC ¶ 61,324 (2004); *Colorado Interstate Gas Co.*, 105 FERC ¶ 61,095 (2003); *Islander East Co., L.L.C.*, 97 FERC ¶ 61,363 (2001); *Millennium Pipeline Co., L.P.*, 97 FERC ¶ 61,292 (2001).

transmission facilities, maintaining that there is no reasonable basis to distinguish between wires that bring electricity to New York City and pipelines that bring gas to the same market. To support its claim, EPI cites to the recent Notice of Proposed Rulemaking (NOPR) regarding investments in facilities for the transmission of electric energy, contending that similar incentives should be applied to gas pipelines like EPI that add interstate pipeline infrastructure and competitive open access opportunities.[55]

(2) Commission Holding

88. EPI proposes a 14 percent return on equity and a capital structure of 52.86 percent equity and 47.14 percent debt. Currently, the existing Empire facilities have a New York approved system-wide return on equity of 12.5 percent with a capital structure of 40 percent equity and 60 percent debt.[56] Our policy requires that rates for a mainline expansion project in a section 7(c) proceeding be designed on the pipeline's approved capital structure and rate of return and we will reduce a proposed rate of return to the one approved in the last rate case, when the pipeline proposes a higher rate than its approved rate of return.[57] Further, when a pipeline proposes an incremental project, we will approve rates that are designed on the rate of return approved in the pipeline's last rate case.[58]

89. Empire is an existing Hinshaw pipeline engaged in interstate commerce and transports gas under section 284.224 with rates, services, and facilities regulated by the New York PSC. Since Empire has an approved rate of return and capital structure authorized by the New York PSC, we will adopt the existing 12.5 percent return on equity and capital structure of 60 percent debt and 40 percent equity for the existing Empire facilities. A 12.5 percent return on equity is within the zone of reasonableness for return on equity as determined recently in the *High Island Offshore* case, where we found that the discounted flow analysis returns for a proxy group of four companies

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[55] *Promoting Transmission Investment Through Pricing Reform*, IV FERC Statutes and Regulations ¶ 32,593 (2005) (Transmission Investment NOPR).

[56] Empire's system-wide rate of return and capital structure were approved by the New York PSC in Opinion No. 96-25, Case 95-G-1002.

[57] *Northwest Pipeline Corp.*, 98 FERC ¶ 61,352 at 62,499 (2002); *Kern River Gas Transmission Co.*, 95 FERC ¶ 61,022 at 61,056 (2001).

[58] *Texas Eastern Transmission, LP.*, 99 FERC ¶ 61,383 at 62,625 (2002); *Kern River Gas Transmission Co.*, 98 FERC ¶ 61,205 at 61,721-22 (2002); *Trailblazer Pipeline Co.*, 95 FERC ¶ 61,258 at 61,903 (2001).

ranged from 10.53 to 13.51 percent.[59] Further, we consider the proposed connector facilities to be an extension of the existing Empire pipeline, rather then a new greenfield pipeline. Thus, consistent with our policy, we will apply the 12.5 percent return on equity and capital structure of 60 percent debt and 40 percent equity to the rates for the connector facilities as well.

90. We have previously addressed requests by electric utility companies to apply precedent establishing rates of return for interstate natural gas pipelines to electric utility rate cases. We declined to do so, stating that "significant differences exist in the electric utility industry and natural gas pipeline industry," including the fact that (1) the restructuring of the natural gas industry was "nearly through" in contrast to the electric industry; (2) at least one large investment firm indicated that it treated electric utilities differently from other companies when estimating growth rates; and (3) electric utilities have a higher dividend payout ratio than most natural gas companies, meaning that they have a lower level of retained earnings which are a key source of dividend growth.[60] We believe these reasons remain persuasive and reject EPI's contention that we should approve an otherwise excessive rate of return on equity in this case because of the Transmission Investment NOPR.

e. Deferred State Income Taxes

91. EPI proposes a $1,161,936 expense for deferred New York states taxes, which are applicable to gas corporations and utilities operating in New York. The proposed expense reflects a three-year amortization of the projected balance of $3,485,808, which represents the deferral amount for this expense as of the projected in-service date.

(1) Pleadings

92. The New York PSC and NYSEG and RG&E are concerned that EPI will over-recover deferred state income taxes. The New York PSC contends that a two-year rate review would be appropriate in light of EPI's proposed three-year amortization of deferred state income taxes. The New York PSC maintains that EPI's proposed three-year rate review would guarantee over-collection because the initial rates, including the

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[59] *High Island Offshore System, L.L.C.*, 110 FERC ¶ 61,043 at P 150-153, *order on rehearing*, 112 FERC ¶ 61,050 (2005).

[60] *Southern California Edison Company*, Opinion No. 445, 92 FERC ¶ 61,070 at 61,260-62 (2000). *See also System Energy Resources*, Opinion No. 446, 92 FERC ¶ 61,119 at 61,443-46 (2000); *Consumers Energy Company,* Opinion No. 456, 98 FERC ¶ 61,333 (2002).

amortization of deferred taxes, will be in effect until the Commission issues an order at the conclusion of the rate review.

93. EPI states that it not seeking to over-recover taxes, claiming that it will file a cost and revenue study after three years of operations as a jurisdictional company.

(2) Commission Holding

94. We find that EPI's proposed three-year amortization of the deferred New York state taxes is appropriate to recover an expense attributable to a tax change that EPI was required to implement by the New York PSC.[61] Thus, we will accept the proposed expense. To ensure that EPI has correctly recovered this expense, we will require EPI to separately report the recovery of this expense in its three-year cost and revenue study, or in a section 4 rate case.

3. Rate Design Issues

a. Discount Adjustment to the Billing Determinants for the Existing Pipeline

95. In developing its proposed reservation rate on the existing pipeline of $7.45 per Dth for annual service, EPI proposes to use billing determinates of 409,201 Dth per day, which will recover $36.8 million or $5.3 million less than the projected $41.9 million cost of service. EPI explains that the current contract demand level on its existing system is 508,615 Dth per day, but designing rates on that throughput level would result in a reservation rate of $6.8710 per Dth, generating approximately $35.1 million which is below the hypothetical $41.9 million cost of service. For this reason, EPI states that it proposed a discount adjustment, reducing the contract throughput level on the existing pipeline to 409,201 Dth per day which will recover $36.8 million.

96. EPI asserts that it has been forced to substantially discount its long-term and short-term firm rates during its 15 years of operation under the jurisdiction of the New York PSC. EPI contends that for the 12 months ending March 31, 2005, the discounted rate generated revenue of $33.5 million, which represents over $4 million less than its approved cost of service of $37.9 million.[62] EPI asserts that a discount adjustment

[61] Case 00-M-1556, Proposed Accounting and Ratemaking for Tax Law Changes, Order Implementing Tax Law Changes (December 21, 2000); Order Implementing Tax Law Changes on a Permanent Basis (June 28, 2001).

[62] Case 95-G-1002, Empire State Pipeline – Rates, Opinion No. 96-25 (September 24, 1996).

should be recognized and that the proposed $7.45 per Dth rate is consistent with the public convenience and necessity standard in section 7. Further, EPI asserts that its existing system is a mature operating pipeline, not properly subject to the Commission's at risk policies applicable to new greenfield projects, and that current policy permits discounts.

(1) Pleadings

97. Sithe contends that EPI has not met the Commission's requirements for a discount adjustment, since it failed to provide any information regarding the contracts and underlying rates or to demonstrate that the discount is necessary to meet competition. Further, Sithe asserts that the discount adjustment may include a reduction for an affiliate and that EPI failed to meet the higher burden required for such requests.

98. Sithe also asserts that the Commission does not review requests by pipelines for discount adjustments in section 7 certificate proceedings. Instead, Sithe states that these issues are generally addressed in a NGA section 4 proceeding where there are opportunities to more fully scrutinize the adjustment proposal. Sithe contends that without an evidentiary hearing, it does not have the ability to scrutinize EPI's proposed adjustment or to meet its burden to produce evidence that discounts to non-affiliates were not justified by competition.

99. In addition, Sithe contends that Commission precedent requires the use of actual design capacity for rate design purposes in setting initial rates in certificate proceedings. Sithe contends that since EPI has no experience operating as an interstate transporter, it is more important that the Commission require EPI to wait to seek a discount adjustment. Sithe also asserts that approval of the discount adjustment could enable EPI to argue in a future rate case that parties opposing the discounts would have a NGA section 5 burden of proof to reverse the certificate order.

100. Sithe contends that the Commission should use EPI's existing contract demand levels, unadjusted for discounts, as well as including a representative level of short-term firm service, in designing initial recourse rates for the existing system.

101. EPI recognizes that its case is unique, but asserts that Sithe's solution would allow no discount adjustment for initial rates and require a section 4 proceeding, which it claims is unduly harsh because it would be penalized during the time its initial rates are in effect.

102. EPI asserts that the existing discounts were designed to meet competition. EPI contends that RG&E holds approximately 32 percent of available firm capacity on its existing system under a contract which expires in 2008 and that RG&E is connected to

another natural gas pipeline. EPI states that National Fuel Distribution (which EPI alleges was not an affiliate at the time the discount was negotiated) is able to access gas through five interstate pipelines, which previously supplied all of National Fuel Distribution's requirements. EPI asserts that the Commission will be able to conduct a comprehensive review of its rates following a period of actual operations. EPI also states that it will file a cost and revenue study following three years of actual operation.

(2) Commission Holding

103. Our policy on selective discounting was most recently reaffirmed in the Commission's policy statement on selective discounting.[63] Generally, our regulations permit pipelines to discount their rates on a non-discriminatory basis in order to meet competition. We have explained that these discounts benefit all customers including customers that do not receive the discounts, because the discounts allow the pipeline to maximize throughput and spread fixed costs across more units of service.[64] We have consistently held that to the extent a pipeline is required to give discounts to attract or retain load, it need not design its rates on the assumption that discounted volumes would flow at maximum rates, but may reduce the discounted volumes so that the pipeline will be able to recover its cost of service.[65]

104. The burden of proof is on the pipeline to show that the discounts are required to meet competition. We distinguish between discounts to non-affiliates and discounts to affiliates when determining the burden the pipeline must meet. If the discount is given to a non-affiliate, we have stated that "there is a reasonable presumption that a pipeline will always seek the highest rate from such shippers, since it is in the pipeline's own economic interest to do so."[66] Once the pipeline has shown that the discounts were given to meet competitive forces, the burden shifts to parties opposing the discount to produce

[63] *Policy for Selective Discounting By Natural Gas Pipelines*, 111 FERC ¶ 61,309 at P 2; *order denying reh'g*, 113 FERC ¶ 61,173 (2005). "[T]he Commission finds that its current policy on selective discounting is an integral and essential part of the Commission's policies furthering the goal of developing a competitive national natural gas transportation market."

[64] *See, e.g., Williams Natural Gas Co.*, 77 FERC ¶ 61,277 (1996); *Panhandle Eastern Pipeline Co.*, 74 FERC ¶ 61,109 (1996); *Southern Natural Gas Co.*, 67 FERC ¶ 61,155 ((1994).

[65] *Panhandle Eastern Pipeline Co.*, 74 FERC ¶ 61,109 (1996).

[66] *Policy for Selective Discounting*, 111 FERC ¶ 61,309 at P 59.

evidence that discounts to non-affiliates were not justified by competition.[67] If the parties opposing the discounts raise reasonable questions concerning the issue of competition, the burden shifts back to the pipeline to show that the discounts were required by competition.[68]

105. We disagree with Sithe that a discount adjustment is not appropriate because this is a section 7 proceeding. While Sithe is correct that we generally establish initial rates in certificate proceedings based on design capacity, we do so to ensure that that the pipeline bears the risk for the cost of new capacity that is not fully utilized.[69] Here, EPI is not proposing a discount adjustment to recover the costs of the new connector facilities. The costs of the connector pipeline will be recovered through an incremental rate based on the design capacity solely from shippers on the connector pipeline. This satisfies the no subsidy requirement of the Certificate Policy Statement and the Policy for Selective Discounting. The discount adjustment is solely for designing the rates for the existing pipeline. Thus, we find that a discount adjustment may be appropriate for the existing facilities, provided that EPI calculates the discount adjustment consistent with our precedent and otherwise meets its burden to show that the discounts are necessary to meet competition.

106. While EPI contends that it used an iterative process to arrive at the proposed level of billing determinants, it does not provide sufficient information for us to determine if the billing determinants are consistent with our policy. To satisfy our discount policy, we will require EPI to use the iterative method of deriving a discount adjustment that compares each discount rate to the initial rate approved in this proceeding (using the approved cost of service and billing determinants unadjusted for discounting), filing such information in conjunction with its revised rates.[70] In support of its adjustment, EPI must make a filing with the Commission that lists each shipper with a discounted contract, the annual discount contract demand and the discount rate, and whether the shipper is an affiliate. Consistent with our policy, EPI must exclude any negotiated rate contracts from the discount adjustment. For any discounts given to an affiliate or non-affiliate, EPI must meet its burden of showing that each discount was given for competitive reasons. Parties

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[67] *Id.*

[68] *Policy for Selective Discounting*, 111 FERC ¶ 61,309 at P 59.

[69] *Certificate Policy Statement*, 88 FERC at 61,747 (1999). *See also* 113 FERC ¶ 61,173 at P 92-99.

[70] *See, e.g., Williston Basin Interstate Pipeline Co.*, 107 FERC ¶ 61,164 at P 80 (2004).

opposing EPI's adjustment may file comments in response to EPI's filing. If a discount is lower than the maximum initial rate, the throughput associated with the transaction can be included in the discount adjustment. Under this process, the service units used for designing rates are reduced with each iteration and divided into the cost of service to arrive at a higher, maximum rate. EPI should perform consecutive iterations until there is no longer a change in the rate. EPI must provide supporting workpapers, studies, and explanations to justify the proposed discount adjustment.

b. National Fuel Distribution's Commodity Rate

107. Currently, Empire transports 40,112 Dth per day of gas on a firm basis for National Fuel Distribution under an agreement with an expiration date of October 31, 2014.[71] EPI's proposal reflects a $0.00 commodity rate for transportation on the existing and connector pipelines. National Fuel Distribution's current transportation agreement provides for a two-component rate structure made up of a commodity component and a demand, or reservation, component.[72]

(1) Pleadings

108. If EPI is allowed to reduce the commodity rate to zero, National Fuel Distribution contends that the commodity rate would be eliminated from the existing agreement's rate structure, leaving only the demand component. National Fuel Distribution asserts that it would be forced to pay more per Dth to EPI than it currently pays to Empire any time it uses the firm transportation agreement at less than a 100 percent load factor. Further, National Fuel Distribution contends that the proposed elimination of the commodity component is an attempt to change the existing rate structure approved by the New York PSC from a modified fixed-variable rate to a straight fixed-variable rate, which arguably would force it to subsidize the connector facilities. National Fuel Distribution concludes that the cost structure it agreed to with Empire should be preserved or, at a minimum, recreated by means of a negotiated rate so that National Fuel Distribution is not unduly disadvantaged.

109. Because National Fuel Distribution uses its service at less than 100 percent throughput, EPI contends that an increase in the minimum commodity rate would result in lower transportation charges and a decrease in the rate would result in higher charges.

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[71] National Fuel Distribution is an LDC subject to the jurisdiction of the New York PSC and the Pennsylvania Public Utilities Commission. National Fuel Distribution is an affiliate of Empire and EPI.

[72] Empire also transports 20,000 Dth per day for National Fuel Distribution under a contract that expires before the in-service date of the proposed facilities.

EPI contends that the parties clearly contemplated the possibility that such upward or downward rate component adjustments could occur, otherwise there would have been no reason to state the formula in that manner. When the New York PSC authorized Empire to construct its facilities, EPI avers that the order allowed Empire to propose a change in rate design. Finally, EPI claims that National Fuel Distribution will not subsidize the connector facilities and that the proposed initial rates applicable to existing customers, like National Fuel Distribution, are derived from the costs attributable to the existing customers.

(2) Commission Holding

110. EPI's proposed recourse rates are based on a straight-fixed variable rate design, which requires that all costs be assigned to the demand component. While EPI's proposed recourse rates comply with the required straight-fixed variable rate design, EPI also proposes negotiated rates, which could provide National Fuel Distribution with the opportunity to negotiate modified fixed-variable rates to preserve its existing rate design. Further, as described above and required by this order, shippers, such as National Fuel Distribution, that transport exclusively on the existing pipeline facilities will not be required to subsidize the cost of the connector facilities. We conclude that National Fuel Distribution is not unduly disadvantaged here.

c. Predetermination of Rate Treatment

111. EPI requests a predetermination that, absent material changes in facts and circumstances shown in a future rate case, the rates applicable to its connector facilities shippers will not bear any portion of the costs associated with the existing system, unless the Commission establishes fully rolled-in rates for shippers on the existing system and the connector facilities. EPI also asserts that a shift in rate design from incremental to "incremental plus" in a future rate case would undercut the financial basis behind the proposal and requests assurances that this will not occur.

(1) Pleadings

112. Sithe contends that the cost of service associated with the proposed incremental recourse rates is understated because the incremental rates do not include any costs associated with the existing system or significant system-wide costs, even though all gas transported on the connector project would have to be transported on the existing system and some of the connector facilities are on the existing system.

113. Sithe also urges the Commission to deny EPI's request for a "predetermination" because EPI has not allocated any costs associated with the existing system to its connector facilities, even though all of the connector project gas must flow through the

existing system. In addition, Sithe contends that other costs included in the cost of service of the existing system (*e.g.*, pipeline integrity costs, costs associated with conversion to regulation by the Commission, and A&G costs, among others) should be subject to re-examination in a rate case to determine if they should be reallocated to the incremental cost of service. Sithe maintains that EPI's requested predetermination would preclude the Commission from examining these cost allocation issues and would insulate EPI from risk, since only expansion customers would be paying a negotiated rate.

114. EPI contends that its predetermination request fits within the Commission's well-established policy to resolve fundamental pricing issues in certificate proceedings before infrastructure is built. EPI states that its request is made so that the Commission will not view the fundamental nature of its project differently in a future rate case and undercut the project's financial basis. Further, EPI asserts that the costs identified by Sithe have nothing to do with the connector project and should not be allocated to expansion shippers unless there is a full roll-in of the connector facilities.

(2) Commission Holding

115. The critical element in reviewing rate design, particularly incremental rates, is to ensure that there is a proper assignment of costs and that the respective customers pay for the service they receive and do not subsidize services rendered on behalf of others. In this case, EPI proposes to convert an existing interstate natural gas pipeline from state to federal jurisdiction, to continue service to the existing customers, and to construct expansion facilities to serve new shippers. The Certificate Policy Statement provides guidance here, because it focuses on whether proposed incremental expansion projects can proceed without subsides from the pipelines' existing customers. In this instance, Empire's existing customers should not pay for the expansion of the system if they do not benefit or receive service from the incremental facilities, nor should EPI be permitted to shift any costs. To further protect the existing customers, we will require EPI to keep separate books and accounting of the costs attributable to both the existing and the expansion systems. The books should be available for EPI's customers to review when EPI submits its three-year cost and revenue study, as required by this order. Further, the books should be maintained with applicable cross-references as required by section 154.309 of the regulations. With these measures in place to protect EPI's existing shippers, we reach a preliminary determination that absent any demonstration that material change in circumstances has occurred, EPI can charge incremental rates in its next rate case. When EPI files its three-year cost and revenue study, parties will have the opportunity to comment on the proposed rate design.

d. Cost Overruns

116. We believe that the potential exists for cost overruns here because the pipeline facilities are to be constructed more than two years after the filing date. We addressed this issue in the Certificate Policy Statement, finding that pipelines should reach an agreement with their new shippers concerning who will bear the risk of cost overruns. The Certificate Policy Statement found that the responsibility for cost overruns should be apportioned between the pipeline and the new customers that have subscribed for the new capacity, so that the overruns will not become the responsibility of the existing shippers.[73] EPI admits that its agreement with KeySpan does not contain this risk-sharing provision. In the application, however, EPI reserves the right to revise its initial rates prior to the commencement of service to reflect the changes in construction costs, unless the parties agree otherwise.[74] If EPI seeks to change the proposed rates prior to placing the facilities into service, it must file a section 7(c) amendment to this filing. If EPI seeks a change after the facilities are placed into service, we will require EPI to make a section 4 rate filing.

e. Negotiated Rates

(1) Proposals

117. Section 18.2 of EPI's General Terms and Conditions (GT&C) permits EPI to enter into negotiated rate transactions, consistent with Commission policy. EPI indicates that it will file with the Commission each negotiated rate agreement, or tariff sheets that include a detailed presentation of the essential elements of the agreement. EPI also states that it will maintain separate and identifiable accounts for volumes transported, billing determinates, rate components, surcharges, and revenues associated with negotiated rate transactions in sufficient detail so that they can be identified in Statements G, J, and I in any future rate proceeding.

118. EPI requests a determination permitting it to charge as negotiated rates, the rates agreed to under its anchor contracts with three existing Empire shippers: RG&E, Sithe, and NYSEG. EPI also seeks a determination that permits it to charge, as negotiated rates, the rates agreed to between EPI and KeySpan. Further, in section 18.2 of its tariff, EPI proposes the right to seek discount-type adjustments in future rate proceedings with respect to negotiated rate transactions that were converted from Empire's existing discount services. EPI explains that this tariff provision clarifies that a negotiated rate

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[73] Certificate Policy Statement, 88 FERC at 61,747 (1999).

[74] Application at 16.

transaction with a shipper with an existing discount service from Empire under an existing New York *pro forma* service agreement would be within the scope of this reservation.

(2) Commission Holding

119. While we will not approve EPI's negotiated rate contracts here, we will accept the proposed tariff language in section 18.2 concerning negotiated rate provisions and the right to seek a discount-type adjustment in future rate proceedings as discussed above. In certificate proceedings, we establish initial recourse rates, but do not make determinations regarding specific negotiated rates for proposed services.[75] In order to comply with the Alternative Rate Policy Statement[76] and our decision in *NorAm Gas Transmission Company*,[77] we will direct EPI to file its negotiated rate contracts, or numbered tariff sheets, not less than 30 days or more than 60 days, prior to the commencement of service, stating for each shipper the negotiated rate, the applicable gas volume to be transported, and an affirmation that the affected service agreements do not deviate in any material respect from the form of service agreement in EPI's *pro forma* tariff. EPI must also disclose all consideration received that is associated with the agreement. Finally, EPI must also maintain separate and identifiable accounts for volumes transported, billing determinants, rate components, surcharges and revenues associated with its negotiated rates in sufficient detail so that they can be identified in Statements G, I, and J in any future section 4 or 5 rate case.

f. Adjustments and Surcharges

120. In section 18.1 of the GT&C, EPI proposes to make rate change filings based in whole or part on factors related to past periods including, but not limited to, changes in the cost of labor, benefits, materials and supplies, taxes, and rate of return.

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[75] *CenterPoint Energy -- Mississippi River Transmission Corp.*, 109 FERC ¶ 61,007 at P 19 (2004); *ANR Pipeline Co.*, 108 FERC ¶ 61,028 at P 21 (2004); *Gulfstream Natural Gas System, LLC*, 105 FERC ¶ 61,052 at P 37 (2003); *Tennessee Gas Pipeline Co.*, 101 FERC ¶ 61,360 at n. 19 (2002).

[76] *Alternative to Traditional Cost-Of-Service Ratemaking for Natural Gas Pipelines and Regulation of Negotiated Transportation Services of Natural Gas Pipelines, Alternative Rate Policy Statement,* 74 FERC ¶ 61,076 (1996), *reh'g and clarification denied,* 75 FERC ¶ 61,024 (1996), *reh'g denied,* 75 FERC ¶ 61,066 (1996); *petition for review denied, Burlington Resources Oil & Gas Co. v. FERC,* Nos. 96-1160, *et al.,* U.S. App. Lexis 20697 (D.C. Cir. July 20, 1998).

[77] 77 FERC ¶ 61,011 (1996).

(1) Pleadings

121. NYSEG and RG&E contend that EPI should remove language from section 18.1 that references several circumstances that EPI could use to justify an allocation of certain costs among shippers based on factors attributable to past periods.

122. EPI contends that section 18.1 is intended to recognize that, in certain circumstances, it may be appropriate to allocate certain costs among shippers based upon factors attributable to past periods, such as contract demand. EPI notes that section 18.1 preserves the rights of shippers to intervene and protest any filing by EPI that seeks to allocate costs as described in the section.

(2) Commission Holding

123. Section 154.403 of the regulations provides for periodic rate adjustments and permits pipelines to recover costs and revenues accumulated over a past period. However, section 154.403(6) provides that the "past period must be defined and the mechanism for the recovery or return must be detailed on a step-by-step basis." We will require EPI to revise section 18.1 to be consistent with the requirements in section 154.403(6).

g. Crediting Interruptible Transportation Revenues

124. In section 18.3 of the GT&C, EPI proposes to credit interruptible transportation revenues. EPI provides that it will retain all revenues under Rate Schedule IT for transportation on the existing pipeline, while revenues for interruptible service on the connector facilities will be credited in accordance with an applicable percentage based on the winter or summer period and whether the shipper is a recourse or negotiated rate shipper.

(1) Pleadings

125. NYSEG and RG&E request an explanation as to why EPI would retain all interruptible revenues on the existing pipeline, but credit revenues to shippers on the proposed connector facilities.

126. EPI contends that its proposal to credit interruptible transportation revenues (amounting to $191,000) to the cost of service reflects the actual level of interruptible business on the existing system for the 12-month period ending March 31, 2005.

(2) Commission Holding

127. EPI's proposed credit of $191,000 for interruptible revenues only reflects transportation on the existing system for the 12-month period ending March 31, 2005. EPI projects no interruptible throughput as the result of the proposed expansion of its system to enter a new market. In the absence of a projection and to protect the maximum rate customers from paying a rate higher than would have been appropriate if interruptible revenues had be projected, we will require EPI to credit interruptible revenues exceeding $191,000 to all firm and interruptible shippers paying the maximum rate.[78]

128. EPI has failed to adequately explain the difference in crediting of interruptible revenues between the existing pipeline, where EPI will retain all revenues, and the connector facilities, where EPI will credit revenues for the most part to the shippers. Thus, when EPI files to revise its *pro forma* tariff, we will require EPI to explain and justify the different treatment of interruptible revenues in section 18.3.

h. Reimbursement of Fuel, Company-Use, and Lost and Unaccounted-For (LAUF) Gas

129. In section 23 of the GT&C, EPI proposes to recover compressor fuel used at the proposed Oakfield compressor station and LAUF gas each month. EPI states that compressor fuel will be recovered from the shippers transporting gas on the connector facilities, because that is why the compressor station was constructed.

(1) Pleadings

130. NYSEG and RG&E contend that section 23 does not provide for the filing of the compressor fuel factor with the Commission, which violates the filed rate doctrine.

131. EPI asserts that the Commission permitted pipelines to provide a notice of monthly fuel adjustment on their websites in *Kern River Gas Transmission Company*.[79] EPI proposes to implement the same procedure as approved in *Kern River* by posting the compressor fuel factor on the internet in advance each month and filing an annual report

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[78] *Maritimes & Northeast Pipeline, L.L.C.*, 84 FERC ¶ 61,130 at 61,682 (1998); *Transcontinental Gas Pipe Line Corp.*, 79 FERC ¶ 61,325 at 62,424-25 (1997).

[79] 87 FERC ¶ 61,228 (1999).

with the Commission. EPI seeks any waivers that may be necessary to effectuate its proposal.

(2) Commission Holding

132. In *Kern River*, we found that reporting the monthly fuel factors on a pipeline's internet web site satisfies the intent of section 154.3 of the regulations. Nevertheless, we determined that the reporting should occur no less than seven calendar days before the beginning of the month in which the factors are to become effective.[80] Thus, we will require EPI to revise its tariff to clearly state that it will report its fuel factors on its internet web site on a monthly basis at least seven calendar days before the beginning of the next month. Further, EPI should revise its tariff to state the date that it will file an annual fuel reimbursement report for each year to support the compressor fuel and LAUF gas factors used for a 12-month period. EPI should file the annual report under section 4 of the NGA, which will provide EPI's shippers and the Commission with a forum to review any of the monthly fuel reimbursement percentages to ensure that the fuel rates are calculated correctly in accordance with EPI's tariff. Also, we will require EPI to revise its tariff to provide that if a negative compressor fuel or LAUF gas factor occurs on a given month, that negative balance must be carried over to the next month.

i. Three-Year Rate Review Requirement

133. Consistent with Commission precedent, we will require EPI to file a cost and revenue study at the end of its first three years of actual operation to justify its existing recourse rate or to propose alternative rates to be effective no later than three years after the in-service date. The filing must include a cost and revenue study in the form specified in section 154.313 of the regulations that updates cost-of-service data for the latest 12-month period including, among other things, the cost of plant-in-service and throughput. The data must delineate between the two segments on EPI's system. In order to enable the Commission to determine the impact of EPI's transportation at negotiated rates, EPI must keep separate information concerning volumes transported, billing determinants, rate components, surcharges, and revenue associated with its negotiated and recourse rates. EPI should include this information as part of Statements G, I, and J in its future rate proceeding. After reviewing the study, we will be able to determine whether to exercise our authority under section 5 to establish just and reasonable rates. In the alternative, in lieu of this filing, EPI may make a section 4 filing to propose alternative recourse rates to be effective no later than three years after the in-service date.

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[80] *Id* at 61,923.

C. Tariff Issues

1. *Pro Forma* Service Agreements

a. Proposals

134. As indicated above, Empire currently has shippers with contracts for firm transportation service.[81] EPI contends that the Commission should not upset these contractual arrangements, but permit it to provide service under those contracts pursuant to its Part 284 blanket certificate for the duration of the term of the contracts. Thus, EPI proposes two Rate Schedule FT *pro forma* service agreements, one that would be available to Empire's existing shippers who executed New York *pro forma* service agreements and a second *pro forma* service agreement for new shippers transporting gas on the existing or the expansion pipeline (standard *pro forma* service agreement). The New York *pro forma* service agreement for the existing shippers differs from the standard *pro forma* service agreement for the new shippers because it includes (1) references to the New York PSC and Empire's New York PSC tariff; (2) provisions regarding *force majeure* payment, responsibility for gas, indemnification and warranty that are built into EPI's *pro forma* tariff and so need not be in the *pro forma* agreement for new shippers; and (3) differences in the presentation of contract-specific information, such as quantities, receipt and delivery points, and pressures. EPI also states that the New York *pro forma* service agreement contains non-conforming provisions that: (1) provide for customized discount or negotiated rates; (2) relate to events that have taken place, or will take place, by the in-service date; (3) give advantage or disadvantage to a shipper relative to other similarly situated shippers that would be eliminated by the proposed tariff or application of Commission policy; and (4) do not degrade service to other shippers, but reflect unique aspects of a particular shipper's transaction with Empire.[82] In regard to the last category, EPI contends that most of these provisions relate to the Sithe electric generation plant. EPI states that when the Empire and Sithe projects were initially contemplated, the projects were mutually interdependent, because Sithe needed transportation from Empire on terms and conditions acceptable to Sithe and its lenders and Empire needed a long-term commitment from Sithe to justify construction of the pipeline. Thus, EPI requests that the Commission approve both forms of the service agreements and the specific non-conforming provisions in the agreements with the longer term shippers.

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[81] *See* P 26-27 above.

[82] *See* Exhibit P, Part 4 of the application for a summary of the non-conforming provisions.

b. Commission Holding

135. Here, EPI proposes to operate its existing system as a jurisdictional interstate pipeline. In order to provide service to Empire's existing customers under the proposed jurisdictional tariff, it is not appropriate for EPI to simply incorporate in its proposed tariff the New York *pro forma* service agreement that is applicable to the service Empire provided as an intrastate pipeline and to grandfather Empire's intrastate contracts with existing shippers. For instance, the New York *pro forma* service agreement refers to Empire's New York PSC tariff, even though the service will be provided under a certificate and tariff approved by the Commission, and includes references to services such as Rate Schedule OPT and Rate Schedule PT, which EPI is not proposing under its jurisdictional tariff. Further, the New York *pro forma* service agreement includes definitions of *force majeure*, waiver, warranty, and indemnification of transporter provisions that contradict similar provisions in the proposed tariff.

136. In order to provide jurisdictional service to its existing shippers, EPI must renegotiate its existing contracts using its standard *pro forma* service agreement as the starting point for drafting any negotiated rate or contract consistent with our policies.[83] To the extent that it wishes to grandfather any provision in Empire's existing contracts, EPI must file the agreements reflecting the deviations from the standard *pro forma* service agreement in red line/strike out format. EPI must also explain the basis for any deviations and demonstrate that the deviations are not unduly discriminatory. We will require EPI to remove the New York *pro forma* service agreement (Sheet Nos. 127-136), as well as any reference to the New York agreements in its proposed tariff. Further, we will require EPI to remove the phrase "Applicable to New Service Agreements Under Rate Schedule FT" from the title of the FT Service on *pro forma* Sheet No. 137.

2. Definition of *Force Majeure*

a. Pleadings

137. Sithe asserts that EPI should remove from its definition of *force majeure* in section 28.6 of its GT&C any description of events that are within EPI's control or that could be avoided by the exercise of due diligence or reasonable efforts.

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[83] *National Gas Pipeline Negotiated Rate Policies and Practices*, 104 FERC ¶ 61,134 (2003).

138. To address Sithe's concerns, EPI proposes to add the phrase "unplanned emergency" prior to the word "repairs" in section 28.6(a). EPI's revised section 28.6(a) reads, in part, as follows:

> (a) Definition. The term "force majeure" as used herein shall mean acts of God, blockades, insurrections, riots, epidemics, landslides, lightning, earthquakes, fires, storms (including, but not limited to, hurricanes or hurricane warnings), crevasses, floods, washouts; arrest and restraints of the government, either Federal or State, civil or military; and civil disturbances. Relative to Transporter's service and solely to the operation of its system, force majeure shall also mean shutdown for purposes of necessary *unplanned emergency* repairs, relocation, or construction of facilities; breakage or accident to machinery or line of pipe; the necessity for testing (as required by governmental authority or as deemed necessary by Transporter for the safe operation thereof), the necessity of making *unplanned emergency* repairs or alterations to machinery or lines of pipe . . . .

b. Commission Holding

139. We have characterized *force majeure* as an event that is beyond the pipeline's control which it could not reasonably avoid.[84] EPI's proposed addition of the phrase "unplanned emergency" adequately addresses our definition of *force majeure*. We will require EPI to revise its definition of *force majeure* in section 28.6 in accordance with its proposal.

3. Parking and Lending (PAL) Service

a. Pleadings

140. NYSEG and RG&E assert that EPI should offer a PAL service, because EPI's tariff contains imbalance penalty provisions and low operating tolerance provisions that increase the likelihood that EPI will be able to extract penalties from its customers.

141. EPI asserts that its current system does not include storage or compression and that it needs experience operating the proposed Oakfield compressor station before it can assess the feasibility of a PAL service. Under its current operations, EPI contends that it cannot imagine a situation where a PAL service could be made available to a shipper that would otherwise be in jeopardy of incurring penalties. EPI asserts that without storage

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[84] *E.g., Florida Gas Transmission Co.*, 107 FERC ¶ 61,074 at P 30 (2004).

directly tied to its system, it would have to rely primarily on line pack as the source of gas to loan or the place for gas to be parked. If the operational stress causing the possibility of penalties is insufficient line pack, EPI points out that only those shippers that are taking too much gas off the system would be vulnerable to penalties, but EPI would not have the gas to loan them. Conversely, if its system is threatened with excessive line pack, EPI asserts that only those shippers that are putting too much gas on the system would be subject to penalties, but EPI would have no place to park their gas. EPI urges the Commission to defer the issue of a PAL service until EPI has operating experience with its proposed facilities.

b. Commission Holding

142. Our regulations provide that pipelines that have imbalance penalty provisions in their tariff are required to provide, to the extent operationally practicable, imbalance management services, such as a PAL service.[85] Further, our regulations provide that pipelines are prohibited from giving undue preference to their own balancing services over such services that are provided by a third party.[86] We have not required pipelines to provide PAL services in circumstances where the pipeline lacks storage facilities that can be used for imbalance management and where the pipeline has limited ability to use line pack for such purposes. Here, EPI has no storage facilities and asserts that it needs experience operating the proposed new Oakfield compressor station before it can assess the feasibility of a PAL service. Under theses circumstances, we will defer ruling on the issue of whether a PAL service is operationally feasible. Rather, we will require EPI to file a report on the feasibility of providing a PAL service one year from the date it places the proposed compressor station in service. Further, we will require EPI to revise its tariff to provide shippers with the opportunity to access third parties that can provide PAL service.

143. EPI, however, has failed to establish tariff provisions permitting shippers to net and trade imbalances as required by section 284.12(b)(2)(ii). We will require EPI to revise its proposed tariff to incorporate netting and trading provisions, which will enable shippers to avoid imbalance penalties.

4. Right of First Refusal

144. Section 2.12 of Rate Schedule FT provides that a shipper with a service agreement of 15 years or more will have the right to extend the agreement at maximum recourse

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[85] 18 C.F.R. § 284.12(b)(2)(iii) (2005).

[86] *Id.*

rates in five year increments. Section 15.1 of the GT&C contemplates a right of first refusal for any shipper holding a service agreement with a term of one year or longer. Neither of these provisions permits a right of first refusal for any shipper with a negotiated rate contract.

a. Pleadings

145. NYSEG and RG&E request an explanation on how sections 2.12 of Rate Schedule FT and 15.1 of the GT&C work together. NYSEG and RG&E assert that they should continue to enjoy a right of first refusal even though their new contract with EPI will terminate in less than 15 years.

146. EPI contends that if a shipper exercises its right under section 2.12, the right of first refusal under section 15.1 would not be applicable because the agreement has not been terminated. Further, EPI explains that if NYSEG and RG&E continue service under their existing agreement which includes negotiated rates, they would not be eligible for the right of first refusal provision under section 15.1, absent an agreement with EPI. As an alterative, EPI avers that NYSEG and RG&E could elect EPI's recourse rates under a new agreement which would be eligible for the right of first refusal if they meet the criteria set forth in section 15.1 and would be subject to the extension right in section 2.12 if the primary term is fifteen or more years.

b. Commission Holding

147. The right of first refusal only applies to maximum rate contracts. There is no right of first refusal for negotiated rate contracts.[87] Thus, any EPI shipper who chooses a negotiated rate contract does not have a right of first refusal, unless the contract specifically provides for that right. For shippers to retain a right of first refusal, they will need to enter into a contract with a recourse rate or a negotiated rate contract which provides for a right of first refusal. In addition, we find that EPI has adequately explained the interplay between section 2.12 of Rate Schedule FT and section 15.1 of the GT&C.

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[87] *Regulation of Short-Term Natural Gas Transportation Service, and Regulation of Interstate Natural Gas Transportation Service, Order No. 637-A*, FERC Statutes and Regulations, Regulations Preambles July 1996 – December 2000 ¶ 31,099 at 31,634 (2000).

5. Crediting for Non-Delivery of Gas

148. Sections 3.6 and 3.7 of Rate Schedule FT refer to the crediting of gas when EPI is unable to make deliveries due to the scheduling of necessary repairs or a *force majeure* situation.

a. Pleadings

149. Amerada Hess[88] contends that crediting for *force majeure* under section 3.7 of Rate Schedule FT should be available to negotiated rate shippers on the same basis as recourse shippers. Amerada Hess also contends that *pro forma* Sheet No. 18 makes the reduction in section 3.7 "subject to the provisions of the General Information." Amerada Hess contends that EPI should provide adequate information that would allow shippers to understand this reference in *pro forma* Sheet No. 18.

150. NYSEG and RG&E assert that the provisions in sections 3.6 and 3.7 of Rate Schedule FT, providing for crediting for *force majeure*, should apply by default and should not only apply if stated in the service agreement.

151. EPI asserts that Rate Schedule FT does not permit the crediting of reservation charges for a negotiated rate agreement in the event of interruption of service for a non-*force majeure* situation under section 3.6 or a *force majeure* situation under section 3.7, unless specifically provided for in the agreement. EPI explains that because section 3.6 appears in Empire's New York tariff, it did not intend to deprive any shipper under an existing agreement the benefit of crediting for a non-*force-majeure* interruption, even if that agreement became a negotiated rate agreement. For this reason, EPI proposes to add the phrase "or unless agreement is a Former N.Y. Service Agreement" at the end of section 3.6

152. EPI contends that because section 3.7, which applies to the crediting of reservation charges for a *force majeure* situation, does not appear in Empire's New York tariff, it did not extend the crediting rights to existing shippers that opt to retain their negotiated rate contracts. EPI asserts that any shipper that elects to sign a new recourse rate agreement would have the right to the crediting of reservation charges for a *force majeure* situation.

[88] Amerada Hess is a producer and marketer of natural gas and a firm shipper on Empire's existing system.

b. Commission Holding

153. We will accept EPI's proposed revisions to section 3.6 of Rate Schedule FT, because it provides shippers under a former New York service agreement the opportunity to share in the crediting of a reservation charge.[89] In order to clarify that sections 3.6 and 3.7 specifically refer to a reservation charge credit when EPI is unable to deliver gas due to non-*force majeure* or *force majeure* events, we will require EPI to revise these tariff provisions to state that they refer to a reservation charge credit. Further, during negotiations for a negotiated rate agreement, the parties can discuss whether to include a reservation credit charge for non-*force majeure* or *force majeure* events in the agreement.

154. EPI included language in section 3.7 of Rate Schedule FT that precludes shippers in negotiated rate agreements from receiving reservation charge credits in *force majeure* events. Amerada Hess contends that reservation charge credits for *force majeure* events should be available to negotiated rate shippers. We agree with EPI that crediting negotiated rate shippers for service interruptions is not consistent with our policy.[90] Thus, we will approve the language in section 3.7 as proposed.

6. Operating Tolerances

155. Section 3.1 of the GT&C provides that gas quantities received by the transporter shall not exceed a daily variance of two percent of the actual deliveries. Under this provision, EPI is permitted to waive the two-percent imbalance tolerance on a not unduly discriminatory basis. In section 4.7 of the GT&C, EPI proposes to assess tiered penalty levels for daily imbalances that exceed two percent, starting at $5 per Dth up to $15 per Dth. EPI proposes to waive the daily imbalance penalty if, in its reasonable judgment, the shippers' actions have not jeopardized EPI's ability to operate the system or impaired its ability to meet its other service obligations.

a. Pleadings

156. NYSEG and RG&E contend that an operating tolerance of two percent in section 3.1 is low and needs to be more generous. If low tolerances are necessary, NYSEG and RG&E contend that EPI should define the circumstances under which it would hold shippers to the two-percent tolerance level.

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[89] Since we are requiring EPI to revise its tariff to eliminate the former New York service agreements, EPI will be required to revise the reference to its existing shippers.

[90] *See Colorado Interstate Gas Co.*, 106 FERC ¶ 61,275 at P 43, *order denying reh'g and granting clarification*, 108 FERC ¶ 61,052 (2004).

157. NYSEG and RG&E assert that sections 4.7 and 3.1 are not consistent, since section 4.7 provides that EPI will waive daily imbalance charges if a shipper's actions have not jeopardized EPI's ability to operate its system or impaired EPI's ability to meet other service obligations. NYSEG and RG&E claim that penalties for imbalances can only be imposed during critical operating periods and that the conditions that define a critical period need to be stated in the operational flow order (OFO) portions of the tariff.

158. NYSEG and RG&E also want to know how section 4.7 (penalties applied on a day-by-day basis) and section 4.9 (monthly cash out of imbalances) interrelate.

159. EPI contends that it needs to limit the daily variation in receipts and deliveries to a greater extent than most pipelines, because it does not have storage on its system and has limited line pack. EPI asserts that its shippers have operated with, and relied upon, the two-percent tolerance level since Empire commenced operations in 1993 and that NYSEG and RG&E have not previously claimed problems meeting this requirement. EPI asserts that the two-percent tolerance level should not be weakened, absent a demonstration that EPI can tolerate greater swings without impairing its operations.

160. EPI objects to NYSEG's and RG&E's suggestion that daily imbalance penalties should only be applicable following the declaration of an OFO. EPI asserts that if a pipeline had to experience operational stress and declare an OFO before it could impose imbalance penalties, it would have no way to deter shipper imbalances that cause operational stress in the first place.

161. EPI contends that section 4.7 imposes a daily imbalance penalty if the shipper can not satisfy the obligation to resolve the imbalance and section 4.9 describes the cash-out method.

b. Commission Holding

162. We find that EPI's proposed two-percent daily tolerance level for daily imbalance penalties and the associated penalty structure is reasonable. EPI has no storage facilities that can be used for imbalance management and may have limited ability to use line pack for such purposes. Moreover, EPI states that it has been operating with the proposed daily two-percent tolerance level since it began operations in 1993. EPI contends that during this time its shippers have not expressed any difficulty in complying with this requirement. Significantly, EPI will waive daily imbalance penalties if it determines that a shipper's actions have not threatened its ability to operate its system or to meet its service obligations. For these reasons, we believe that EPI's proposal complies with our requirement that substantial penalties can be applied only during critical periods.[91] We disagree with NYSEG's and RG&E's assertion that EPI should have authority to invoke

[91] *See, e.g., Questar Pipeline Co.*, 98 FERC ¶ 61,159 at 61,584 (2002).

a daily penalty only after it has issued an OFO. Requiring EPI to declare an OFO before it could impose an imbalance penalty would severely restrict EPI's means of deterring shipper imbalances that may cause the operational stress in the first place.

7. Imbalance Resolution

163. In sections 4.7, 4.8, 4.9, and 4.10 of the GT&C, EPI proposes various imbalance provisions including daily imbalance penalties, imbalance resolution, cash out provisions, and resolving cumulative imbalances when the contract is terminated.

a. Pleadings

164. NYSEG and RG&E raise concerns about the in kind and cash out options in section 4.8. NYSEG and RG&E also assert that the point where gas sales or purchases are made to balance or maintain operational integrity should be identified in section 4.9(c) and should be as far upstream as possible.

165. In section 4.10, NYSEG and RG&E suggest that EPI be required to provide an accounting on how it will credit the difference between amounts received from shippers for monthly imbalances under the cash-out option and amounts incurred by EPI for monthly imbalances and for the cost of buying gas to cure imbalances.

166. EPI clarifies that an "election between the in kind and cash out methods would be applicable to imbalances arising during subsequent calendar months, and thereafter unless and until an election is made to change the method, which would again have prospective application effective the following month."[92] Further, EPI asserts that an election could be made as often as once per month, but a change would not affect the resolution of imbalances that have already arisen or that arise prior to the commencement of the following month. If the Commission believes that this clarification of the tariff is required, EPI indicates that it would include the appropriate language.

167. EPI contends it will come under the Commission's jurisdiction as a transportation-only pipeline with authority to make operational purchases and sales ancillary to the transportation function. EPI asserts that costs and revenues would be flowed through to its shippers and, on the occasions that it would use this authority, EPI should have the flexibility to make purchases and sales at the points that offer the greatest economic or operational advantage to its system. For example, EPI states that if on a given day gas is available at EPI's interconnection with Dominion's system at Lysander, New York at a lower price than at TransCanada's interconnection at Chippawa (the most upstream

[92] EPI's February 6 answer at 41.

point), EPI should be free to purchase gas at Lysander. EPI asserts that it is willing to provide the basis for its calculations when it flows through cash out proceeds.

b. Commission Holding

168. We agree with NYSEG and RG&E that the tariff language needs to be revised to address how sections 4.7, 4.8, and 4.9 work in conjunction with each other. EPI states that it will make these clarifications including, but not limited to, clarifying shippers' rights to elect a method of resolution, as referenced in section 4.8(a).

169. NYSEG and RG&E assert that section 4.9(c), which addresses gas purchases or sales to balance the system, must identify the point at which such purchases or sales will be made. This is a standard requirement for all pipelines and we will require EPI to state in its tariff the point at which purchases and sales will be made. In addition, NYSEG and RG&E assert that EPI must specify a point as far upstream as possible. Consistent with section 284.283 of the regulations, we will require EPI to revise its tariff to designate the furthest upstream point on its system as the point for gas sales.

170. Section 4.10 specifies how EPI will credit the difference between amounts received from shippers for monthly imbalances and amounts incurred by EPI for monthly imbalances and the cost of buying gas to cure imbalances. NYSEG and RG&E request that EPI be required to provide an accounting to shippers of the calculation. We agree and will require EPI to include language in section 4.10 which states that EPI will provide an accounting of these credits to all shippers and the basis of the calculation.

8. Liability in Damages

171. Section 8 of the GT&C describes the circumstances under which EPI will not be liable in damages to a shipper, other than for acts of gross negligence or willful misconduct and conditions of *force majeure*.

a. Pleadings

172. NYSEG and RG&E contend that EPI should be liable to shippers for ordinary negligence, rather than only for "gross negligence," as specified in section 8.

173. EPI acknowledges that section 8 is not consistent with current Commission policy. EPI asserts that the Commission has permitted limitations of damages to direct damages except in the case of gross negligence, willful misconduct, or bad faith actions. Thus, EPI proposes the following language for section 8:

> Except as otherwise provided in these [GT&C] or Shipper's service agreement, in no event shall Shipper or Transporter be liable to the other

> for special, indirect, consequential (including loss of profits), incidental or punitive damages, whether or not such damages arise out of breach of contract, negligence, tort, or strict liability; provided, however, unless otherwise agreed to by Transporter and Shipper, the foregoing shall not limit Transporter's liability, if any, to Shipper, nor Shipper's liability, if any, to Transporter, arising out of gross negligence, willful misconduct, or bad faith actions. Nothing in this provision will limit Transporter's liability, if any, to Shipper, nor Shipper's liability, if any, to Transporter, for direct damages.

b. Commission Holding

174. We will accept EPI's proposed revisions to section 8 as consistent with the decision in *ANR Pipeline Company*[93] and require EPI to revise its tariff consistent with the proposed language above. In *ANR*, we accepted similar tariff language, finding that the phrase "unless otherwise agreed to by Transporter and Shipper" would not apply to liability arising out of gross negligence, willful misconduct, or bad faith actions. We also found that information on this provision must be posted on the pipeline's web site, because the posting will allow shippers to monitor the pipeline's contracting practices with respect to perceived discrimination.[94] Thus, we will require EPI to post information concerning section 8 on its web site.

9. Capacity Release Provisions

175. Section 12.7 of the GT&C provides that when an existing shipper releases capacity, the shipper is responsible for demand and capacity charges and any surcharges, excluding commodity or usage charges. Under this section, however, a negotiated rate shipper remains liable for commodity or usage charges, if the negotiated rate agreement so provides, or the shipper is subject to a New York *pro forma* service agreement.

a. Pleadings

176. NYSEG and RG&E contend that section 12.7(ii) is contrary to the Commission's policy, because it provides that a negotiated rate shipper that releases capacity shall remain liable for commodity or usage charges, if its negotiated rate agreement so provides, or the shipper is subject to a New York *pro forma* service agreement. Under

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[93] 100 FERC ¶ 61,132 (2002).

[94] *ANR* at 61,505-06.

the Commission's policies, NYSEG and RG&E assert that there is no requirement that a releasing shipper continue to be liable for the usage rate.

177. EPI contends that section 12.7(ii) is necessary to prevent an unwarranted windfall opportunity for the shipper at EPI's expense. EPI asserts that one or more of Empire's existing contract rates are based on a modified fixed-variable rate design and that it proposes to continue service at these stated rates as negotiated rates. If a shipper elects to stay with its modified fixed-variable contract and release some or all of its capacity, EPI asserts that its proposed tariff language would not impose a restriction on the shipper's flexibility to structure release transactions and the shipper would be free to release the capacity at the same rates it is paying EPI. EPI contends, however, that the proposed language is needed to protect it from losing the benefit of the commodity charge that it can recover under the New York tariff and that, without this provision, a shipper could achieve an unwarranted windfall because the shipper will receive reservation charge credits for the higher amounts paid by the replacement shipper. With respect to existing Empire customers only, EPI contends that the Commission should permit it to retain the feature that requires the releasing shipper to remain responsible for commodity charges, which would preserve the bargain struck between Empire and its existing shippers.

b. Commission Holding

178. In Order 636-A, we clarified that the releasing shipper cannot be held liable for the replacement shipper's usage rates, because the releasing shipper cannot control the usage of the replacement shipper.[95] However, even though the pipeline cannot hold the releasing shipper liable for usage charges or penalties, this issue can be the subject of negotiation between the pipeline and its releasing shippers. Thus, we will require EPI to revise section 12.7(ii) to conform to our precedent.

10. Reservation of Capacity for Expansion Projects

179. Section 17 of the GT&C provides that EPI can solicit for the release of capacity from its existing shippers to reduce the scope of an expansion project when it contemplates constructing expansion facilities.

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[95] Order No. 636-A, FERC Statutes and Regulations, Regulations Preambles July 1996 – December 2000 ¶ 30,950 (1992). ("After the release of capacity, the replacement shipper, not the releasing shipper, is the party shipping the gas and therefore the replacement shipper is responsible for paying the usage charge to the pipeline.") *See also Crossroads Pipeline Co.*, 71 FERC ¶ 61,076 at 61,266 (1995).

a. Pleadings

180. NYSEG and RG&E request that the term “release” of capacity in section 17 be replaced by “turn back,” when EPI solicits for capacity that may reduce the scope of future expansions.

181. EPI asserts that the word “release” is a better than “turn back,” because it does not want to create the impression that it may only solicit offers for the outright termination of service. For example, EPI asserts that the Commission permitted pipelines to require incremental rate shippers to continue to pay the difference between the incremental rate and the rate the expansion shipper would pay for the capacity made available by the existing shipper. EPI also contends that sometimes the pipeline may only require a segment of the capacity held by an existing shipper, or may only require the existing shipper’s capacity for an interim period.

b. Commission Holding

182. We agree with NYSEG and RG&E that the language in section 17 should be revised to use the term “capacity turn back,” rather than “capacity release.” The term “capacity release” is a term of art generally used to refer to the ability of a firm shipper to release voluntarily all or part of their firm capacity rights to a potential shipper or to a pre-arranged shipper. We find that the term “capacity turn back” is more appropriate here, where the tariff addresses the reservation of capacity for expansion projects and may be used to refer to the partial or complete turn back of capacity.[96]

11. Requests for Service Involving Construction of New Facilities

183. Section 2.2(f) of the GT&C permits shippers to request service that requires EPI to construct facilities. When this occurs, EPI may require a non-creditworthy shipper to provide security up to a value of the cost of the facilities and a creditworthy shipper to commit to provide security in the event the shipper becomes non-creditworthy.

a. Pleadings

184. Amerada Hess requests that the language in section 2.2(f) be modified to reflect the possibility that multiple shippers may request EPI to construct facilities and that each

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[96] *See, e.g., Tennessee Gas Pipeline Co.,* 86 FERC ¶ 61,066 (1999); *Northwest Pipeline Corp.*, 94 FERC ¶ 61,206 (2001); *Kern River Gas Transmission Co.*, 94 FERC ¶ 61,205 (2001).

individual shipper should be required to post security only for its allocable share of the facilities.

b. Commission Holding

185. Consistent with our precedent, we will require EPI to revise section 2.2(f) to state that a shipper's obligation to provide security is proportionate to its share of the cost of the facilities.[97] Also, we have found that pipelines should remove collateral requirements for mainline system expansions from their tariff.[98] Thus, we will require EPI to revise section 2.2(f) to clarify that its collateral requirements apply only to lateral line facilities.

12. Reimbursement for the Construction of New Facilities

186. Section 11.1 of the GT&C provides that a shipper shall reimburse EPI for the cost of new facilities agreed to by the shipper, with reimbursement payable within 10 days of receipt of the bill by the shipper. Section 11.2 provides that EPI at its discretion may waive all, or a portion of, the facility reimbursement charge set forth in section 11.1.

a. Pleadings

187. Amerada Hess notes that sections 11.1 and 11.2 provide that shippers are expected to reimburse costs up front for the construction of facilities to receive, measure, transport, or deliver gas but that EPI has broad discretion on whether to waive the reimbursement requirement. Amerada Hess asserts that shippers should not be automatically required to reimburse costs up front. Rather, Amerada Hess requests that the Commission direct EPI to explain the circumstances in which EPI would refuse to waive the up front reimbursement costs to ensure that the waivers are granted on a non-discriminatory basis. In the alternative, Amerada Hess believes that EPI should notify a prospective shipper prior to the execution of a precedent agreement whether these costs will be required up front or amortized.

b. Commission Holding

188. When a pipeline constructs a measurement, receipt, or delivery facility to serve a particular customer, the pipeline can request reimbursement for those facilities.[99] Thus,

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[97] *Tennessee Gas Pipeline Co*., 103 FERC ¶ 61,275 at P 29 (2003).

[98] *Id*. at P 26.

[99] *See, e.g., Transcontinental Gas Pipe Line Corp.*, 113 FERC ¶ 61,165 (2005).

we find that it is appropriate for EPI's tariff to require reimbursement for the construction of measurement, receipt, or delivery facilities. However, if as provided in section 11.2, EPI waives all or a portion of the facility reimbursement requirement, we will require EPI to explain the circumstances under which the waiver is granted to insure that the waiver is granted on a non-discriminatory basis. Thus, we will require EPI to revise section 11.2 to provide that it will post on its EBB the circumstances under which it will waive the cost reimbursement requirement for the construction of facilities to measure, transport, or deliver natural gas for a shipper.

13. Miscellaneous Tariff Changes

189. Consistent with its March 7 data response to question 16, we will require EPI to file revised tariff sheets to Sheet Nos. 6 and 7, which provide in the footnotes a better explanation of the applicability of the FT and IT rates. Further, we will accept the non-conforming provision in the KeySpan service agreement, referenced earlier in this order, since EPI's tariff will not be in effect at the time the service agreement is executed.[100] We will permit EPI to include similar language in its agreements with other shippers subscribing to the connector project prior to the tariff becoming effective.

14. Confidentiality of Agreements

190. EPI requests confidential treatment for the existing Empire anchor transportation contracts.

191. Section 4(c) requires that pipelines file with the Commission and "keep open . . . for public inspection, schedules showing all rates and charges for any transportation or sale subject to the jurisdiction of the Commission . . . together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services." A fundamental purpose of this requirement is to provide the Commission and public with the ability to ensure against undue discrimination in a pipeline's contracting practices with respect to jurisdictional services.[101]

192. Where a pipeline's service agreement with a customer for transportation service conforms to the form of service agreement in the pipeline's tariff, that service agreement need not be filed with us or made public.[102] Since the Commission and other interested

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[100] See P 28 of the order.

[101] *NorAm Gas Transmission Co.*, 77 FERC ¶ 61,011 at 61,038-39 (1996); *ANR Pipeline Co.*, 65 FERC ¶ 61,280 at 62,304-06 (1993).

[102] 18 C.F.R. § 154.210 (2005).

parties have had an opportunity to determine that the form of service agreement provided in the tariff is just and reasonable and not unduly discriminatory, there is no need to review subsequent conforming contracts to determine if they comply with the NGA.[103] However, where a contract deviates materially from the form of service agreement, the Commission and the public have not had an opportunity to review the material deviation, and the contract must be filed and made public.[104] We require disclosure of contracts with material deviations, because the public disclosure of these agreements prevents undue discrimination through secret rates or terms.

193. For these reasons, EPI must make public its service agreements if the agreements have a material deviation from the form of service agreement in EPI's tariff. The agreements should be filed at least 30 days prior to the commencement of service.

D. Request for Waivers

1. Waiver of Section 284.286

194. EPI requests a waiver of section 284.286 of the regulations, which sets forth the standards of conduct governing pipeline marketing affiliates. EPI states that it may need to make purchases or sales of incidental quantities of gas due to excess or insufficient line pack because of shipper imbalances, differences between current fuel retainages and actual fuel consumption at the Oakfield compressor station, and high or low LAUF quantities. EPI asserts that the incidental, operational sales would not represent a merchant function.

195. EPI claims that its purchases or sales would be infrequent, incidental, and not large. Based on these representations, we find that it would be unduly burdensome to require EPI to establish a separate marketing department. Thus, we will waive the requirements in section 284.286 so that EPI can make the purchases or sales of gas described in the application.[105]

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[103] *ANR Pipeline Co.*, 97 FERC ¶ 61,224 at 62,022 (2001).

[104] 18 C.F.R. § 164.1(d) (2005).

[105] *See, e.g.*, *Dominion Transmission, Inc.*, 106 FERC ¶ 61,029 (2004); *Dominion Cove Point LNG, LP*, 104 FERC ¶ 61,218 (2003); *Columbia Gulf Transmission Co.*, 100 FERC ¶ 61,344 (2002).

2. Waiver of Shipper Must Hold Title Policy

196. Section 13(a) of its GT&C provides that EPI may acquire capacity on third party systems and provide service using the acquired capacity under the rates, terms, and conditions in EPI's tariff. Thus, EPI requests a generic waiver of the Commission's shipper must hold title policy.

197. In *Texas Eastern Transmission Corporation*, we found that pipelines no longer need to obtain prior approval to acquire capacity on another pipeline provided the acquiring pipeline filed tariff language specifying that it would only transport for others on off-system capacity under its existing tariff and rates.[106] EPI's proposed tariff language is consistent with the requirements set forth in the *Texas Eastern* order. Thus, we will accept EPI's tariff language and grant a waiver of the shipper must hold title policy.

E. Engineering

198. Our analysis of the flow diagrams and flow information submitted in the application shows that after the installation of the proposed 78-mile connector facilities and Oakfield compressor station, the newly expanded pipeline system will be able to transport an additional 250,000 Dth per day during the winter and 221,100 Dth per day during the summer for delivery to Millennium. Our analysis also shows that the proposed expansion and extension of the Empire pipeline will allow EPI to maintain existing system operating pressures. By doing so, the proposals herein will not have an adverse impact on EPI's ability to provide firm transportation service to Empire's existing customers.

VI. Request for Technical Conference and Evidentiary Hearing

199. The New York PSC requests a technical conference to discuss rate issues or, in the alternative, an evidentiary hearing. Sithe also requests an evidentiary hearing.

200. We find that the record including the application, responses to data requests, and accepted pleadings contain sufficient information and data to make a reasoned decision on the merits. Thus, we find that no purpose would be served by convening a technical conference.

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[106] 95 FERC ¶ 61,056 (2001).

201. Section 7 of the NGA provides for a hearing when an applicant seeks a certificate of public convenience and necessity, but does not require that all such hearings be formal, trial-type hearings. An evidentiary trial-type hearing is necessary only when there are material issues of fact in dispute that cannot be resolved on the basis of the written record.[107] The New York PSC and Sithe have not raised material issues of fact that cannot be resolved on the basis of the written record. The written evidentiary record provides a sufficient basis for resolving the issues relevant to this proceeding. We have satisfied the hearing requirement by giving interested parties an opportunity to participate through evidentiary submissions in written form.[108] Thus, we will deny the New York PSC's and Sithe's requests for an evidentiary hearing.

VII. Conclusion

202. For the reasons set forth herein, we find, subject to completion of our environmental review and EPI's acceptance of the conditions set forth below, that EPI's proposed Empire connector project is in the public convenience and necessity under section 7 of the NGA. Further, the benefits of EPI's proposals will outweigh any potential adverse effects and will be consistent with the Certificate Policy Statement and section 7(c). Thus, we will make a preliminary determination to grant the requested authorizations to EPI.

203. At a hearing held on July 20, 2006, the Commission on its own motion received and made a part of the record in this proceeding all evidence, including the application and exhibits thereto, submitted in support of the authorizations sought herein, and upon consideration of the record,

The Commission orders:

(A) A preliminary determination is made that a certificate of public convenience and necessity under section 7(c) of the NGA should be issued to EPI authorizing it to construct and operate the Empire connector project and to operate the existing Empire pipeline facilities, as described and conditioned herein, subject to the environmental review of the proposals and issuance of a final order.

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[107] *See, e.g.*, *Southern Union Gas Co. v. FERC*, 840 F.2d 964, 970 (D.C. Cir. 1988); *Cerro Wire & Cable Co. v. FERC*, 677 F.2d 124 (D.C. Cir. 1982); *Citizens for Allegan County, Inc. v. FPC*, 414 F.2d 1125, 1128 (D.C. Cir. 1969).

[108] *Moreau v. FERC*, 982 F.2d 556, 568 (D.C. Cir. 1993).

(B) A preliminary determination is made that a blanket transportation certificate should be issued to EPI under Subpart G of Part 284, subject to the environmental review of the proposal and issuance of a final order.

(C) A preliminary determination is made that a blanket construction certificate should be issued to EPI under Subpart F or Part 157, subject to the environmental review of the proposal and issuance of a final order.

(D) Any authority granted in the final order in this proceeding shall be conditioned upon EPI's compliance with all regulations under the NGA including, but not limited to, Parts 154 and 284, and paragraphs (a), (c), (e), and (f) of section 157.20 of the regulations.

(E) Any authority granted in the final order in this proceeding shall be conditioned upon EPI's facilities being constructed and made available for service within three years of the date of the final order in this proceeding.

(F) EPI's requests for waivers of the Commission's regulations are granted, as discussed in the body of this order.

(G) EPI shall submit revised *pro forma* tariff sheets that comply with the requirements contained in the body of this order within 60 days of the date of this order.

(H) EPI shall revise its recourse rates in accordance with the discussion in the body of this order and file the rates and work papers supporting the revised recourse rates in conjunction with the revised *pro forma* tariff required in Ordering Paragraph (G).

(I) Empire's section 284.224 blanket certificate is terminated on the in-service date of proposed connector facilities.

(J) The New York PSC's request for a technical conference is denied.

(K) The New York PSC's and Sithe's requests for an evidentiary hearing are denied.

(L) Millennium's, Amerada Hess', and Alicia Leppert's and William Taylor's untimely motions to intervene are granted.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.