

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Tennessee Gas Pipeline Company

Docket No. CP05-100-000

ORDER GRANTING WAIVER OF BLANKET CERTIFICATE COST LIMIT

(Issued December 26, 2006)

1. On March 31, 2005, Tennessee Gas Pipeline Company (Tennessee) filed a request pursuant to its Part 157, Subpart F blanket certificate and the prior notice procedures in sections 157.205, 157.208, and 157.216 of the Commission's blanket certificate regulations under the Natural Gas Act (NGA)¹ for authorization to construct or modify certain pipeline facilities offshore Louisiana (Louisiana Deepwater Link Project) to connect its Line 500 system to the Independence Trail deepwater gathering system. No protests were filed, and pursuant to section 157.205(h) of the Commission's regulations authorization for Tennessee's project became effective on May 24, 2005.²

2. On August 25, 2006, Tennessee filed a request for waiver of the prior notice cost limits when it realized that the actual construction cost of the project would exceed the cost limitation for prior notice blanket certificate projects as set forth in the Commission's regulations. On September 11, 2006, Consolidated Edison Company of New York, Inc. and Orange and Rockland Utilities (Con Edison and O&R) jointly submitted a letter objecting to rolled-in rate treatment for the project. Con Edison and O&R did not intervene in the prior notice proceeding, and thus have no standing to participate in this matter. Nevertheless, because Con Edison and O&R could not be expected to have anticipated that Tennessee would exceed the blanket certificate regulations' prior notice cost limit, we will consider their views below.

¹ 18 C.F.R. §§ 157.205, 157.208, and 157.216 (2006).

² The KeySpan Delivery Companies, Anadarko Petroleum Corporation, Atmos Energy Corporation, ConocoPhillips Company, and ExxonMobil Gas & Power Marketing Company, a Division of Exxon Mobil Corporation, filed requests to intervene in the proceeding, but did not protest or otherwise object to Tennessee's proposal.

Background

3. In this proceeding, Tennessee sought authority under the prior notice procedures of the Commission's blanket certificate regulations to construct and upgrade offshore supply lateral facilities to enable connection of its system to a deepwater gathering system located offshore Louisiana. Specifically, Tennessee proposed to construct a 2,083-foot long, 24-inch diameter supply lateral, increase the maximum operating pressure of its 526C-100 line from 1,139 psig to 1,250 psig, construct a 298-foot long extension of the 526C-100 line, and abandon a 3,081-foot segment of the 526C-100 line. Tennessee estimated the cost of the project at \$10.6 million, well below the applicable 2005 prior notice blanket certificate cost ceiling of \$22 million.³

4. Under section 157.205 of the Commission's blanket certificate regulations, a prior notice project involving construction of eligible facilities within the specified cost limit is authorized so long as no protest is filed within 45 days of the date notice is issued by the Commission. Tennessee's project, as proposed, satisfied the blanket certificate requirements for such projects. As noted above, no protests were filed and the project was authorized on May 24, 2005 without further action by the Commission.

5. On March 1, 2006, Tennessee requested an extension of time to complete its project.⁴ Tennessee explained that it could not complete the project on time because of a shortage of dive boats, lay barges, and other equipment needed to perform this work. Tennessee stated that these types of vessels were currently deployed on projects related to repairing pipeline damage caused by Hurricanes Katrina and Rita and that it expected that this equipment would be in great demand for some time. On March 8, 2006, the Commission granted Tennessee an extension of time until November 24, 2007 to complete construction and place the project in service.

Tennessee's Waiver Request

6. Tennessee states that it began construction of the project in May 2006, still expecting to complete the project well below the applicable 2005 prior notice cost limit of \$22 million, even if it should experience an unexpected large cost overrun beyond its

³ 18 C.F.R. § 157.208(d) (2005).

⁴ Commission regulations require that a project authorized under blanket certificate procedures be completed and made available for service within one year of the date the activity is authorized – in this case, March 24, 2006. *See* 18 C.F.R. § 157.206(c) (2006).

original \$10.6 million estimate. As detailed below, however, Tennessee experienced problems that resulted in cost overruns significantly greater than it had foreseen. In its August 25, 2006 waiver request, Tennessee revised its project cost estimate upward to \$25.1 million. On October 24, 2006, Tennessee revised its estimate again to project a cost of \$35.8 million for completion of the project. According to Tennessee's October 2006 filing, updated construction reports indicate that its estimated costs continue to rise.

7. Tennessee attributes the significantly higher construction cost primarily to an unprecedented spike in the cost of offshore pipeline installation following Hurricanes Katrina and Rita, although it has also encountered some project-specific difficulties during construction as well. Tennessee stated that the hurricanes have caused installation costs alone to nearly triple from \$6.8 million to \$18 million, largely because of a sharp increase in the cost to hire offshore vessels. For example, Tennessee states that the cost of a diver support vessel has risen from the \$80,000 per day it budgeted to \$210,000 per day. Similarly, the vessel cost for laying, burying, and testing pipeline, Tennessee states, has increased from an estimated \$100,000 to \$120,000 per day to \$225,000 to \$250,000 per day, in part, because the single vessel it had planned to use was not available, necessitating the use of two vessels to perform these tasks. Tennessee also explains that it has experienced unexpected costs of \$1.6 million related to hydrostatic testing and leak repairs, approximately \$479,000 to recover stuck pigs, and \$420,000 to uncover subsea valves for blowdown.

8. Tennessee argues that granting a waiver of the blanket certificate regulations' prior notice cost ceiling under these circumstances is reasonable and equitable. It also points out that in recognition of the damage to Gulf of Mexico pipeline infrastructure caused by the two hurricanes, the Commission has temporarily increased the prior notice cost ceiling from \$22 million to \$50 million. Although this project received authorization before the Commission raised the cost limit for blanket certificate projects, Tennessee emphasizes that its project is nonetheless designed to provide additional supplies of natural gas from the Gulf of Mexico into the interstate pipeline grid, and that the project has been affected by the same hurricane-related problems affecting offshore pipeline infrastructure that gave rise to the temporary increase in the blanket certificate cost limits.

Discussion

The Temporary Waiver of the Blanket Certificate Cost Limit

9. The Commission did in fact recognize the severe disruption to the natural gas pipeline system in the Gulf of Mexico caused by Hurricanes Katrina and Rita. In response to the situation, the Commission, on November 18, 2005, raised the cost ceiling on a temporary basis for projects that natural gas companies may construct without prior

specific authorization under their Part 157, Subpart F blanket certificates.⁵ To expedite the construction of infrastructure providing access to additional supplies of natural gas following the loss of natural gas production, processing, and transportation infrastructure in the Gulf Coast region as a result of the two destructive hurricanes, the Commission increased, as pertinent here, the costs of projects that can be constructed under the blanket certificate prior notice provisions from \$22.0 million to \$50.0 million. This temporary waiver of Commission regulations originally applied only to projects constructed and placed in service by October 31, 2006; however, in an order issued February 22, 2006, the Commission extended the waiver for facilities that could be constructed and placed in service by February 28, 2007.⁶

10. The Commission finds that the temporary increase in the cost limit for prior notice projects should apply to Tennessee's project. While authorization of this project took effect several months before the hurricanes, and thus before the Commission adopted the temporary waiver, Tennessee's construction activity was significantly impacted by Hurricanes Katrina and Rita, both in terms of the availability of construction vessels that resulted in our granting an extension of time for completing the project, and in terms of the dramatic increase in the costs of employing those vessels and other equipment once they would become available for Tennessee's project. Tennessee's project exhibits the characteristics of projects the Commission intended to be within the purview of the temporary waiver, and Tennessee's latest cost estimate remains under the Commission's \$50 million dollar temporary waiver cap.

Rolled-in Rate Treatment

11. Con Edison and O&R contend that Tennessee has not justified rolled-in rate treatment here for a project that will exceed the cost limit set forth at section 157.208 of the Commission's blanket certificate regulations. They assert that Tennessee has submitted no evidence that its proposed roll-in of the costs for the Louisiana Deepwater Link Project would either benefit Tennessee's system customers or not result in subsidies from those customers. They argue that in *Destin Pipeline Company, L.L.C. (Destin)* the

⁵ See *Expediting Infrastructure Construction to Speed Hurricane Recovery*, 113 FERC ¶ 61,179 (2005).

⁶ See *Expediting Infrastructure Construction to Speed Hurricane Recovery, order extending deadline*, 114 FERC ¶ 61,186 (2006).

Commission addressed a similar waiver request involving costs that exceeded the blanket certificate cost limit and found that Destin had submitted sufficient information to warrant rolled-in rate treatment.⁷

12. It has long been established that a presumption of rolled-in rate treatment uniformly applies to construction projects that qualify for approval under the blanket certificate program without a case-specific analysis of potential system benefits. The 1982 rulemaking adopting the blanket certificate program explained that the rates that would be charged for service over blanket facilities would already have been approved in a previous rate proceeding.⁸ The Commission has applied a presumption in favor of rolled-in rate treatment for the costs of blanket certificate projects because of the *de minimis* impact on a pipeline system's overall rates.⁹ The Commission specifically adopted this presumption in its 1995 Pricing Policy Statement,¹⁰ and continued the approach in its 1999 Certificate Policy Statement.¹¹ In a 2005 prior notice proceeding, the Commission specifically found that blanket construction is exempt from the case-specific rate review required in non-blanket certificate proceedings because it is anticipated that blanket facilities will be priced on a rolled-in basis.¹² In its recent rulemaking amending the blanket certificate regulations, which in part raised the cost ceilings for blanket certificate projects on a permanent basis, the Commission determined that it would continue to apply a presumption that blanket certificate costs will qualify for

⁷ *Destin Pipeline Company, L.L.C.*, 83 FERC ¶ 61,308 (1998); *order denying rehearing and stay*, 85 FERC ¶ 61,024 (1998); and *order denying waiver, granting certificate and requiring applicant to show cause*, 88 FERC ¶ 61,119 (1999).

⁸ *See Interstate Pipeline Certificates for Routine Transactions*, Order No. 234, 47 *Fed. Reg.* 24254 (June 4, 1982); 47 *Fed. Reg.* 30724 (July 15, 1982), *FERC Statutes and Regulations, Regulations Preambles 1982-1985*, ¶30,368, at 30,201.

⁹ *See Tennessee Gas Pipeline Company*, 82 FERC ¶ 61,081 (1998).

¹⁰ *See Pricing Policy for New and Existing Facilities Constructed by Interstate Pipelines (Pricing Policy Statement)*, 71 FERC ¶ 61,241 (1995).

¹¹ *See Certification of New Interstate Natural Gas Pipeline Facilities (Certificate Policy Statement)*, 88 FERC ¶ 61,227 at n. 3 (1999).

¹² *See Tennessee Gas Pipeline Company, order denying rehearing*, 111 FERC ¶ 61,094 (2005).

rolled-in rate assessment.¹³ The final rule temporarily increasing cost limits following Hurricanes Katrina and Rita, moreover, specifically provided that the Commission would treat the costs of blanket certificate facilities under the waiver in the same manner as other facilities constructed under blanket certificate authority, *i.e.*, with a presumption of rolled in rate treatment.¹⁴

13. While the *Destin* proceeding did involve a request for waiver of the blanket certificate cost limit, neither the factual situation nor the Commission's holding in that proceeding apply here. In *Destin*, the Commission denied the pipeline's waiver request, because of the fact that Destin should have known that the project would exceed the cost limit before it started construction, Destin's failure to apprise the Commission of its cost overrun in a timely manner, and the magnitude of the cost overrun. In *Destin*, the Commission recognized that, after construction begins, situations that the pipeline did not in good faith anticipate may arise that increase the estimated cost over the ceiling. The Commission explained that pipelines have the responsibility to keep the Commission apprised of significant cost overruns on a timely basis. Destin, the Commission found, knew that its project would not be eligible for blanket certificate treatment before it began construction, but Destin did not inform the Commission of its cost problems until more than two months after placing the facilities in service.

14. In contrast to the *Destin* situation, we find here that Tennessee's actions and calculations have been reasonable in view of the very unusual circumstances attendant to recent pipeline construction activity in the Gulf of Mexico. Unlike Destin, who's original estimate was within three percent of the cost ceiling applicable at the time, Tennessee's original construction cost estimate of \$10.6 million was less than half of the applicable 2005 blanket certificate cost ceiling of \$22 million. Thus, even though it recognized that the effect of the hurricanes would be to increase construction costs well beyond its estimate, we find that Tennessee appropriately believed when it began construction that it still had a sufficient cushion to complete the project within the blanket certificate cost limit. We find that Tennessee's cost overruns, while high, are the direct result of Hurricanes Katrina and Rita, rather than from any deliberate or careless actions by Tennessee. Moreover, unlike Destin, Tennessee has recognized its responsibility to keep

¹³ *Revisions to the Blanket Certificate Regulations and Clarification Regarding Rates*, 117 FERC ¶ 61,074 at P 38 (2006). The Commission explained that the validity of the presumption could be addressed in an NGA section 4 rate proceeding.

¹⁴ 113 FERC ¶ 61,179 at P 9 (2005).

the Commission informed of its cost progression, first by orally notifying Commission staff of the situation, and then by filing this written waiver request to the Commission during construction, not waiting until after placing the facilities in service.

15. In *Destin*, as Con Edison and O&R point out, the Commission's final approval of the project did examine the rate impact and the benefits for Destin's shippers from rolled-in rate treatment for the project's costs. However, the Commission did so in the context of an NGA section 7(c) case-specific analysis, not under blanket certificate procedures. The Commission explained that Destin's project no longer qualified for a presumption of rolled-in pricing as a blanket certificate facility; however, the Commission applied its then existing pricing policy for section 7(c) certificate applications,¹⁵ and approved rolled-in rate treatment in Destin's next NGA section 4 rate case, subject to an examination of the prudence or necessity of any particular cost overrun expenditure.¹⁶ Here, in contrast, we find that Tennessee's project qualifies as a blanket certificate project because it was reasonable for Tennessee to believe, when it started construction of the project, that its costs would not exceed the applicable cost ceiling. We further find that it is appropriate to grant Tennessee's waiver request because both the nature of the project and the cost of the project fall within the Commission's temporary waiver of the prior notice blanket certificate cost limit for such projects. Thus, as explained above, a presumption of rolled-in rate treatment will apply.

The Commission orders:

(A) Tennessee's request for waiver of the applicable blanket certificate cost limit is granted, as described in the body of this order.

(B) Tennessee's project costs qualify for a presumption of rolled-in rate treatment.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.

¹⁵ See *Pricing Policy Statement*, 71 FERC ¶ 61,241 (1995).

¹⁶ *Destin*, 88 FERC ¶ 61,119 (1999).