UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

High Island Offshore System, L.L.C. Docket No. RP06-540-000

ORDER ACEEPTING AND SUSPENDING TARIFF SHEETS SUBJECT TO REFUND AND CONDITIONS, AND ESTABLISHING A HEARING

(Issued September 28, 2006)

1. On August 31, 2006, High Island Offshore System, L.L.C., (HIOS) filed revised tariff sheets[1] pursuant to section 4 of the Natural Gas Act proposing a general increase in its transportation rates. HIOS proposes an effective date of October 1, 2006, for its tariff sheets. HIOS also proposes a new short-term firm transportation service and revisions to its existing rate schedules and General Terms of Conditions (GT&C). The Commission accepts and suspends HIOS' revised tariff sheets to be effective March 1, 2007, subject to refund, conditions, and the outcome of the hearing established herein.

Background

2. HIOS is an interstate pipeline company that owns and operates three pipelines delivering gas from production areas in the Western Gulf of Mexico to a point where the three pipelines converge at High Island Block A-264. HIOS operates a 42-inch mainline which extends from this point of convergence northward for 66 miles where it interconnects with the systems of three other interstate pipelines. HIOS' currently effective rates were implemented in its last rate case in Docket No. RP03-221-000.[2]

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[1] See Appendix.

[2] *See* 102 FERC ¶ 61,088 (2003).

Details of the Filing

3. HIOS proposes to increase its rates for jurisdictional transportation service. HIOS asserts it is proposing new rates because of the dramatic cost increases and throughput decreases it has been experiencing on it system since its last rate increase. HIOS further asserts that during the twelve-month period ending June 30, 2006, its transportation revenues were $3.0 million less than its authorized revenue requirement. HIOS bases its rates on a proposed $42.5 million cost of service, an increase from the $23.6 million cost of service underlying its currently effective rates. HIOS states that it calculates the cost of service using the twelve-month base period ending June 30, 2006, incorporating known and measurable adjustments projected to occur during a test period ending March 31, 2007. HIOS' cost of service includes approximately $31.6 million in operation and maintenance expenses, $1.5 million in depreciation expenses, $3.7 million in negative salvage, a $4.2 million management fee, and $1.8 million in taxes. HIOS' cost of service also includes $265,417 in revenue credits. HIOS asserts its operation and maintenance expenses include unavoidable and dramatic increases in insurance costs triggered by hurricanes Katrina and Rita. It also asserts it is faced with higher maintenance costs associated with operating a 27-year-old pipeline in a harsh offshore environment. HIOS also proposes to recover costs associated with a 36-month maintenance plan it seeks to implement.

4. HIOS states that it has a negative rate base for its system and proposes a $4.2 million management fee in order to provide a return allowance. HIOS further states that this management fee represents an increase from the $1.7 million management fee underlying its currently effective rates. HIOS asserts it calculated its management fee using the same methodology the Commission used to calculate HIOS' currently effective management fee, with one modification, which is described in its testimony. HIOS further asserts that, absent this management fee, it could not afford to continue operations. HIOS states that it calculates its proposed rates using an average daily throughput of 408,000 Dt per day, a decrease from the average daily throughput of 709,000 Dt per day it used to calculate its currently effective rates. HIOS asserts it has never came close to achieving the design throughput underlying its currently effective rates, and does not expect the general trend of declining throughput to reverse in the near or long term because of declining production in its region.

5. In addition, HIOS proposes to implement a new Rate Schedule FT-3 service, which is a short term, term-differentiated firm service for contracts of one year or less. HIOS proposes to design its IT rates using the 100-percent load factor of its Rate Schedule FT-3 rates. HIOS also proposes changes to its existing Rate Schedules FT-1 (previously named FT) and FT-2 which include a new 10 percent billing ratchet and one-year minimum term in Rate Schedule FT-1 and an unauthorized overrun penalty for critical days in Rate Schedules FT-1 and FT-2. HIOS seeks to change the billing of Rate Schedule FT-2 from commodity billing to a reservation and commodity structure and

include a Maximum Daily Quantity (MDQ) adjustment. HIOS also seeks to implement these rate schedule changes only for contracts executed on or after October 1, 2006. Finally, HIOS proposes modifications to reflect the proposed service revisions and incorporate new provisions concerning third party charges and off-system capacity.

Notice

6. Notice of HIOS filing was issued on September 5, 2006. Interventions and protests were due as provided in section 154.210 of the Commission's regulations, 18 C.F.R. §154.210. Pursuant to rule 214, 18 C.F.R. § 385.214, all timely filed motions to intervene and any motions to intervene out-of-time filed before the issuance date of this order are granted. Granting late intervention at this stage of the proceeding will not disrupt this proceeding or place additional burdens on existing parties. ExxonMobil Gas & Power Marketing Company, a Division of Exxon Mobil Corporation, (ExxonMobil) and Chevron U.S.A. Inc. (Chevron) filed protests. ExxonMobil requests the Commission set HIOS' proposal for hearing. Chevron asks for summary rejection of HIOS' proposal, or in the alternative, requests that the Commission set it for hearing.

7. The protesters raise numerous concerns with HIOS' proposal, including those related to, *i.e.*,: (1) the rate increase and rate design; (2) cost of service; (3) operation and maintenance expenses; (4) return on equity; (5) management fee; (6) negative salvage rate; (7) billing determinants; (8) FT-3 rate schedule service; and (9) proposed MDQ adjustments to FT-2 service.

Discussion

8. We believe that HIOS' proposed rate and tariff changes raise issues which are best addressed in a hearing. Accordingly, we accept HIOS' proposed tariff sheets for filing and suspend their effectiveness for the period set forth below, to become effective March 1, 2007, subject to refund and the conditions set forth in this order. Further, we reject Chevron's request that the Commission summarily reject HIOS' proposal. The Commission finds that the proposed tariff sheets raise issues that require further investigation at a hearing before an Administrative Law Judge. Therefore, we set all issues in the subject filing for hearing.

Suspension

9. Based upon a review of the filing, the Commission finds that the proposed tariff sheets listed in the Appendix to this order have not been shown to be just and reasonable, and may be unjust, unreasonable, unduly discriminatory, or otherwise unlawful. Accordingly, the Commission shall accept such tariff sheets for filing and suspend their effectiveness for the period set forth below, subject to the conditions set forth in this order.

10. The Commission's policy regarding rate suspensions is that rate filings generally should be suspended for the maximum period permitted by statute where preliminary study leads the Commission to believe that the filing may be unjust, unreasonable, or that it may be inconsistent with other statutory standards. *See Great Lakes Gas Transmission Co.*, 12 FERC ¶ 61,293 (1980) (five-month suspension). It is recognized, however, that shorter suspensions may be warranted in circumstances where suspensions for the maximum period may lead to harsh and inequitable results. *See Valley Gas Transmission, Inc.*, 12 FERC ¶ 61,197 (1980) (one-day suspension). Such circumstances do not exist here. Accordingly, the Commission will suspend the revised tariff sheets listed in the Appendix to this order for five months and will permit them to take effect March 1, 2007, subject to refund and subject to the conditions set forth in the body of this order and the ordering paragraphs below.

<u>The Commission orders</u>:

(A) The tariff sheets listed in the Appendix to this order are accepted and suspended, to be effective March 1, 2007, subject to refund and conditions and subject to the outcome of the hearing established in this proceeding.

(B) Pursuant to the authority of the Natural Gas Act, particularly sections 4, 5, 8 and 15 thereof, a public hearing will be held in Docket No. RP06-540-000 concerning the lawfulness of HIOS' filing.

(C) A Presiding Administrative Law Judge, to be designated by the Chief Administrative Law Judge for that purpose pursuant to 18 C.F.R. § 375.304, must convene a prehearing conference in this proceeding to be held within twenty (20) days after issuance of this order, in a hearing or conference room of the Federal Energy Regulatory Commission, 888 First Street, N.E., Washington D.C. 20426. The prehearing conference shall be held for the purpose of establishment of a procedural schedule. The Presiding Administrative Law Judge is authorized to conduct further proceedings in accordance with this order and the Commission's rules of practice and procedure.

By the Commission

(S E A L)

Magalie R. Salas,
Secretary.

Appendix

High Island Offshore System, L.L.C.
Third Revised Volume No. 1

Tariff Sheets Conditionally Accepted and Suspended Effective March 1, 2007

Third Revised Sheet No. 1
Ninth Revised Sheet No. 2
Third Revised Sheet No. 4
Third Revised Sheet No. 5
Fifth Revised Sheet No. 10
Second Revised Sheet No. 14
Third Revised Sheet No. 15
Fourth Revised Sheet No. 16
First Revised Sheet No. 17
First Revised Sheet No. 18
Second Revised Sheet No. 19
First Revised Sheet No. 20
Third Revised Sheet No. 21
First Revised Sheet No. 22
Second Revised Sheet No. 23
First Revised Sheet No. 24
First Revised Sheet No. 25
Third Revised Sheet No. 28
Second Revised Sheet No. 29
Third Revised Sheet No. 30
Fourth Revised Sheet No. 31
Fourth Revised Sheet No. 32
Second Revised Sheet No. 36
Original Sheet No. 36A
Second Revised Sheet No. 44
Original Sheet Nos. 45-52
Fourth Revised Sheet No. 64
Fifth Revised Sheet No. 69
Fourth Revised Sheet No. 70
Second Revised Sheet No. 72
First Revised Sheet No. 76
Second Revised Sheet No. 79
Fourth Revised Sheet No. 88
Second Revised Sheet No. 89
Third Revised Sheet No. 100
Third Revised Sheet No. 101
Third Revised Sheet No. 103
Third Revised Sheet No. 114
Second Revised Sheet No. 117
First Revised Sheet No. 122
Second Revised Sheet No. 123
Third Revised Sheet No. 123A
Fourth Revised Sheet No. 134
Fourth Revised Sheet No. 139
Second Revised Sheet No. 143
First Revised Sheet No. 144
Second Revised Sheet No. 150
Sixth Revised Sheet No. 173
Second Revised Sheet No. 173B
Original Sheet No. 173C
Fifth Revised Sheet No. 174
Second Revised Sheet No. 177
Third Revised Sheet No. 178
First Revised Sheet No. 202