

131 FERC ¶ 61,034  
UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;  
Marc Spitzer, Philip D. Moeller,  
and John R. Norris.

Bay Gas Storage Company, Ltd.

Docket No. PR08-17-000

ORDER ON BRIEFS

(Issued April 15, 2010)

1. This proceeding involves a dispute between Bay Gas Storage Company, Ltd. (Bay Gas) and Florida Gas Transmission Company (Florida Gas) regarding the applicability of Bay Gas' recently-approved Lost and Unaccounted-For (LAUF) fuel charge to the discounted firm transportation service agreement executed between Bay Gas and Florida Gas in 1997. Florida Gas asserts that Bay Gas' application of the LAUF charge to its contract results in a breach of that contract, while Bay Gas asserts that its Statement of Operating Conditions (SOC) and General Terms & Conditions (GT&C) on file with the Commission permits it to assess the charge. In this order, the Commission addresses the briefs filed by Bay Gas and Florida Gas in response to the January 6, 2010 Order on Staff Panel in this proceeding.<sup>1</sup> The Commission finds that Bay Gas' in-kind LAUF charge is a non-discountable part of Bay Gas' filed rate which Florida Gas must pay. However, the Commission also finds that Bay Gas must credit the value of its in-kind fuel recovery from Florida Gas toward payment of the fixed discounted rate in the Firm Agreement, so as to maintain the economic value of their bargain.

**I. Background**

2. Bay Gas is an intrastate natural gas pipeline in Alabama that provides interstate transportation and storage services under section 311 of the Natural Gas Policy Act of 1978 (NGPA).<sup>2</sup> Bay Gas and Florida Gas entered into a series of agreements whereby Bay Gas would transport gas for Florida Gas, thus allowing Florida Gas to avoid building

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<sup>1</sup> *Bay Gas Storage Co., Ltd.*, 130 FERC ¶ 61,016 (2010) (Order on Staff Panel), *rehearing pending*. The Commission will address the pending rehearing requests in a later order.

<sup>2</sup> 15 U.S.C. § 3371 (2004).

a pipeline parallel to Bay Gas' facilities to serve its customer Alabama Power Company (Alabama Power), which built a cogeneration plant in Washington County, Alabama.

3. On December 10, 1997, Bay Gas and Florida Gas entered into a Firm Interstate Transportation Agreement (Firm Agreement) pursuant to which Bay Gas will accept, transport and redeliver a Maximum Daily Transportation Quantity (MDTQ) of 32,000 MMBtu per day of gas submitted by Florida Gas to the Olin Cogeneration Plant owned by Alabama Power. The Firm Agreement had a primary term of 10 years, with a roll-over option for an additional 10 years. During the primary term, Florida Gas was to pay a fixed rate of \$0.022 per MMBtu for its MDTQ, with an additional redelivery charge of \$0.005 per MMBtu of gas actually delivered. The Firm Agreement specifies that the risk of loss for all gas redelivered under the agreement will be with the party which has control and possession over the gas at that time. Specifically, it provides: "The risk of loss for all gas delivered and redelivered hereunder shall be and remain with the party having control and possession of the gas as herein provided."<sup>3</sup> The Firm Agreement also includes a provision that "[t]his Contract is subject to all present and future valid laws now or hereafter having jurisdiction of either or both parties ...."<sup>4</sup>

4. Also on December 10, 1997, Bay Gas and Florida Gas entered into a second agreement (Master Agreement), which includes three attachments: the Firm Agreement referenced above, an interruptible service agreement which expired by its own terms on November 30, 2008 and an interruptible storage agreement which also is no longer in effect. The Master Agreement gives Florida Gas the option to acquire up to an additional 32,000 MMBtu on Bay Gas' system, as well as the option to roll over the Firm Agreement for an additional 10 years at a rate equal to thirty percent (30%) of the total transportation charge to Alabama Power under its contract with Florida Gas, and not less than \$0.027 per MMBtu. Florida Gas has exercised this roll-over right. Florida Gas uses the Master Agreement and Firm Agreement to serve its customer, Alabama Power, which we understand from the parties' pleadings to be a maximum-rate customer of Florida Gas. The Master Agreement contains the following provision:

This Agreement and the rights and obligations of the Parties hereunder are subject to all applicable present and future laws, rules, regulations, acts, restraints and orders of any legislative, regulatory or judicial body or any duly constituted authority having jurisdiction over Bay Gas or [Florida Gas].<sup>5</sup>

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<sup>3</sup> Firm Agreement § 13.3.

<sup>4</sup> Firm Agreement § 12.2.

<sup>5</sup> Master Agreement § 9(i).

5. On February 28, 1998, Florida Gas filed an application for a certificate to (1) acquire firm and interruptible capacity on Bay Gas' intrastate pipeline and (2) construct facilities interconnecting the Bay Gas system with the cogeneration plant in Washington County, Alabama. As part of that filing, Florida Gas submitted the Firm Agreement and Master Agreement for the Commission's approval. On April 30, 1998, the Commission issued an order approving Florida Gas' application.<sup>6</sup> However, the Commission found that Bay Gas did not have on file with the Commission a proper rate for NGPA section 311 transportation-only service. Accordingly, the Commission ordered Bay Gas to make a rate election or rate filing under section 284.123 of the Commission's regulations applicable to service under section 311 of the NGPA.

6. Bay Gas filed a petition seeking Commission approval of its SOC, GT&C and transportation rate in Docket No. PR99-3-000 on December 22, 1998 and later amended certain documents. In April 1999, the Commission approved an uncontested settlement (1999 Settlement) resolving all of the issues in that docket, including the SOC and GT&C.<sup>7</sup> At the time, the maximum rate on Bay Gas' system was a monthly reservation service rate of \$0.9541 per MMBtu for firm service and \$0.03137 per MMBtu for interruptible service. An estimate of fuel costs was included in the cost of service and up until Bay Gas' filing in March 2007 for authority to establish a fuel tracker, fuel costs were recovered in the base rate. Further, the GT&C approved in that proceeding included the following section (Section IV) on Bay Gas' right to change its rates:

Bay Gas reserves the right to seek authorization from the Federal Energy Regulatory Commission ("FERC") or other appropriate agency *to increase, decrease or restructure the rates* (including market based rates), *and Company Use charges in effect at any time as may be found necessary to assure Bay Gas' right to charge and collect fair and equitable rates* within the meaning of Section 311(a)(2) of the Natural Gas Policy Act of 1978 ("NGPA") and the FERC's rules and regulations thereunder. Nothing herein contained shall be construed to deny any Shipper any rights which it may have under FERC rules and regulations, including the right to participate fully in rate proceedings by intervention or otherwise to contest changes in rates and Company Use charges in whole or in part. In addition to the rates above, Shipper

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<sup>6</sup> *Florida Gas Transmission Co.*, 83 FERC ¶ 61,101 (April 30, 1998 Certificate Order), *reh'g denied*, 83 FERC ¶ 61,327 (1998).

<sup>7</sup> *Bay Gas Storage Co., Ltd.*, 87 FERC ¶ 61,107 (1999).

shall pay in advance all applicable state and federal filing, reporting and application fees incurred by Bay Gas for providing such services.<sup>8</sup>

7. Section X of Bay Gas' Statement of Operating Conditions, as amended, provides:

This Statement of Operating Conditions, and the incorporated General Terms and Conditions [] take precedence over conflicting language in any of Bay Gas' Service Agreements or amendments thereto.<sup>9</sup>

8. On March 9, 2007 in Docket No. PR07-9-000, Bay Gas proposed, among other things, to amend its GT&C to add a Section II(E) establishing a tracker mechanism for the in-kind recovery of LAUF costs through a "Company Use charges reimbursement percentage (Company Use Percentage)." Shippers on Bay Gas' system, including Southern Company Services, Inc. (Southern Company Services) on behalf of Alabama Power, intervened in the proceeding, but Florida Gas did not intervene.

9. On November 26, 2007, Florida Gas sent a letter to Bay Gas, exercising its roll-over rights to extend the Firm Agreement for an additional 10 years, until November 30, 2018. Florida Gas specified an MDTQ of 32,000 MMBtu at a total rate of \$0.029 per MMBtu. Bay Gas counter-signed the letter and acknowledges in its Initial Brief that the letter was effective in extending the parties' agreement.

10. While Bay Gas' proposal to establish a fuel tracker mechanism was pending, on February 29, 2008, in Docket No. PR08-17-000, Bay Gas made its first annual tracker filing to adjust its Company Use Percentage. Bay Gas proposed to increase its Company Use Percentage to 0.96 percent, effective March 1, 2008. The proposed Company Use Percentage included a "revised percentage component" of 0.574 percent to recover projected LAUF during the following year. The proposed Company Use Percentage also included a true-up component of 0.381 percent. Bay Gas asserted that its actual LAUF during the March 9 to December 31, 2007 period exceeded the 0.18 percent reference figure from the Settlement in Docket No. PR07-9-000 by 160,715 MMBtu. Southern Company Services, Shell Energy North America (US), L.P., and Florida Gas protested Bay Gas' filing. In its intervention and subsequent protest, Florida Gas stated that it received a letter on June 4, 2008 from Bay Gas, contending that the LAUF charge applies

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<sup>8</sup> Bay Gas Initial Brief, Appendix B, General Terms and Conditions at 7, Section IV(A) (emphasis added).

<sup>9</sup> The Commission subsequently required Bay Gas to remove a proviso at the end of Section X, which stated, "unless such language specifically states that it is an exception to this Statement, and then only to the extent of such stated exception." *Bay Gas Storage Co., Ltd.*, 126 FERC ¶ 61,018, at P 22-24 (2009) (January 12, 2009 Order).

to the Firm Agreement. Florida Gas then protested Bay Gas' filing, arguing that the LAUF charge cannot apply to the Firm Agreement as it contains a fixed rate. Florida Gas further asserted that it does not "challenge or address" the settlement in Docket No. PR07-9-000 establishing the LAUF fuel tracker, but reserves the issue of whether its Firm Agreement allows Bay Gas to recover fuel on an in-kind basis.

11. On January 12, 2009, the Commission approved an uncontested settlement in Docket No. PR07-9-000, establishing a tracking mechanism for recovery of LAUF gas in Bay Gas' GT&C.<sup>10</sup> As part of the settlement, Bay Gas agreed to include a true-up component as part of its proposed LAUF tracking mechanism. The settlement also lowered both Bay Gas' proposed base rates and its initial Company Use Percentage, as compared to the initial filing. The settlement lowered the Company Use Percentage from the originally proposed 0.18 percent to 0.10 percent; however, the settlement provided that Bay Gas would use the 0.18 percent figure as the reference figure for true-up in the following year.

12. Because the parties were unable to settle Bay Gas' true-up filing in Docket No. PR08-17-000, the January 12, 2009 Order directed Staff to institute a Staff Panel, pursuant to section 284.123(b)(2)(ii) of the Commission's regulations, to determine whether the updated LAUF percentages reflected in Bay Gas' petition are fair and equitable. On February 26, 2009, the Commission's Staff conducted the Staff Panel. In various pleadings, Bay Gas asked the Commission to determine the issue of whether the LAUF charge applies to the Firm Agreement,<sup>11</sup> while Florida Gas noted that it is not raising issues regarding applicability of the LAUF charge to the Firm Agreement, since it is litigating those issues in Texas state court.<sup>12</sup>

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<sup>10</sup> January 12, 2009 Order, 126 FERC ¶ 61,018. In that same proceeding, the Commission approved an increase to Bay Gas' section 311 transportation rates: on its mainline system, \$2.4247 per MMBtu for firm service and \$0.0797 per MMBtu for interruptible service, and on its Whistler spur facilities, \$1.2186 per MMBtu for firm service and \$0.0401 per MMBtu for interruptible service.

<sup>11</sup> *See, e.g.*, Answer of Bay Gas Storage Co., Ltd. to Florida Gas Transmission Co., LLC, Motion for Leave to Intervene, Protest and Request for Summary Action, or in the Alternative, Request for Consolidation and Hearing at 1-3, Docket No. PR09-13-000 (Mar. 25, 2009).

<sup>12</sup> *See, e.g.*, Brief of Florida Gas Transmission Co., LLC, at 3 n.7, Docket No. PR08-17-000 (Mar. 20, 2009); Florida Gas Transmission Co., LLC, Motion for Leave to Intervene, Protest and Request for Summary Action, or in the Alternative, Request for Consolidation and Hearing at 3 n.4, Docket No. PR09-13-000 (Mar. 10, 2009).

13. In the Order on Staff Panel issued on January 6, 2010, the Commission approved Bay Gas' petition to establish the LAUF tracking mechanism to be effective March 1, 2008, finding that Bay Gas demonstrated that its proposed total LAUF of 0.96 percent, composed of a Base Component of 0.574 percent and a True-up Component of 0.381 percent, was fair and equitable. However, the Commission also required further briefing by the parties regarding the Firm Agreement between Florida Gas and Bay Gas.

### **Judicial Proceedings**

14. In the interim, on October 6, 2008, Florida Gas filed suit in the 190<sup>th</sup> Judicial District Court of Harris County, Texas, alleging that Bay Gas has breached its contract with Florida Gas by withholding a percentage of the gas to be delivered to Florida Gas to collect the LAUF charge, in violation of the Firm Agreement's fixed rate. Bay Gas removed the matter to the federal courts, alleging federal question jurisdiction, but the court granted Florida Gas' motion to remand back to the Texas state court.<sup>13</sup>

15. On February 3, 2010, a Texas state court granted Florida Gas' motion for partial summary judgement. Florida Gas describes that order as "deciding that Bay Gas does not have contract authority to charge [Florida Gas] a separate LAUF charge."<sup>14</sup>

## **II. Procedural Matters**

16. On February 26, 2010, Florida Gas filed a motion for leave to file limited answer and limited answer to Bay Gas' reply brief, and on March 3, 2010, Bay Gas filed an answer to Florida Gas' limited answer. Although the Commission's regulations prohibit such answers,<sup>15</sup> the Commission will accept both the February 26, 2010 Florida Gas limited answer and March 3, 2010 Bay Gas answer, as these pleadings have assisted us in our understanding of these complex issues.

17. In the Order on Staff Panel, the Commission asked the parties to confirm whether they agree to public disclosure of the Firm Agreement between Florida Gas and Bay Gas, which Florida Gas included with its November 29, 2009 filing. Both parties provided such consent in their initial briefs.

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<sup>13</sup> *Florida Gas Transmission Co. v. Bay Gas Storage Co., Ltd.*, 2009 WL 361592 (S.D. Tex. Feb. 11, 2009).

<sup>14</sup> Florida Gas Limited Answer at 2-3. We note that the court order included in Attachment A of Florida Gas' Reply Brief does not include a discussion of the court's reasoning or scope of the partial grant of summary judgement.

<sup>15</sup> 18 C.F.R. § 385.213 (2009).

18. Further, in the Order on Staff Panel, the Commission asked Bay Gas to clarify whether: (1) it agrees that Florida Gas' November 26, 2007 letter properly extended the Firm Agreement with Florida Gas, and (2) the interruptible service agreement remains in effect. The Commission also asked Bay Gas to provide any other relevant contracts and agreements between itself and Florida Gas regarding firm and interruptible service under section 311. Bay Gas responds that Florida Gas' November 26, 2007 letter was effective in extending the firm service agreement; however, the interruptible service agreement was not extended and terminated at the end of its stated term (November 30, 2008). Bay Gas did not include any additional agreements between the parties.

### III. Discussion

#### A. Jurisdictional Issues

19. Bay Gas and Florida Gas raise questions regarding the Commission's jurisdiction vis-à-vis the Texas state court, both in their briefs to the Commission and in the pleadings before the courts, included as attachments to their briefs in the instant proceeding. Florida Gas argues that since this is a contractual dispute between two parties, applying Texas state contract principles, the Texas state courts should decide the matter. Further, according to Florida Gas, this contract dispute does not meet the test for the Commission's exercise of its primary jurisdiction, as articulated in *Arkla v. Hall*.<sup>16</sup> Bay Gas argues that the Commission is the only entity with the authority to establish the rates and terms for a jurisdictional pipeline offering jurisdictional service. According to Bay Gas, the filed rate doctrine prohibits the Texas state courts from substituting their judgment for that of the Commission.

20. Both Bay Gas and Florida Gas are FERC-jurisdictional entities. Although Bay Gas is an intrastate pipeline, it provides service to Florida Gas under section 311 of the NGPA and pursuant to the SOC and GT&C approved by the Commission.<sup>17</sup> Florida Gas, as an interstate pipeline, is a FERC-jurisdictional pipeline under section 4 of the Natural Gas Act (NGA).<sup>18</sup> Further, the agreement at issue in the proceeding is on file with the Commission as a FERC-jurisdictional agreement.<sup>19</sup>

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<sup>16</sup> *Arkansas Louisiana Gas Co. v. Hall*, 7 FERC ¶ 61,175 (1979), *reh'g denied*, 8 FERC ¶ 61,031 (1979).

<sup>17</sup> *Bay Gas Storage Co., Ltd.*, 87 FERC ¶ 61,107 (1999).

<sup>18</sup> 15 U.S.C. § 717c (2006).

<sup>19</sup> April 30, 1998 Certificate Order, 83 FERC ¶ 61,101.

21. In determining whether to assert its primary jurisdiction over disputes concerning jurisdictional contracts, the Commission considers three factors: (1) whether the Commission possesses some special expertise which makes the case peculiarly appropriate for Commission decision; (2) whether there is a need for uniformity of interpretation of the type of question raised in the dispute; and (3) whether the case is important in relation to the regulatory responsibilities of the Commission.<sup>20</sup> In cases of contract interpretation, the Commission has concurrent jurisdiction with the courts.<sup>21</sup> Whether to exercise primary jurisdiction is a matter solely within the Commission's discretion.<sup>22</sup>

22. The Commission will exercise primary jurisdiction in this case to the extent necessary to ensure that the rates Bay Gas charges Florida Gas are consistent with the Commission's regulations and the filed rate doctrine. Under section 311 of the NGPA, an intrastate pipeline may transport natural gas on behalf of an interstate pipeline, at rates approved by the Commission which must be "fair and equitable" and "reasonably comparable" to the rates charged for similar service by an interstate pipeline.<sup>23</sup> Further, under the filed rate doctrine, a regulated entity cannot charge a rate different from the rates on file with the Commission. In interpreting the filed rate doctrine, courts have held that "when there is a conflict between the filed rate and the contract rate, the filed rate controls."<sup>24</sup>

23. The determination of whether Bay Gas' implementation of a tracking mechanism to recover its LAUF costs on an in-kind basis permitting Bay Gas to assess the in-kind LAUF charge against Florida Gas involves the interpretation of several matters particularly within the Commission's specialized expertise. The contentions of the parties focus on (1) whether Section IV of Bay Gas' GT&C, in which Bay Gas reserved

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<sup>20</sup> *Arkla v. Hall*, 7 FERC ¶ 61,175 at 61,322.

<sup>21</sup> *Kentucky Utilities Co.*, 109 FERC ¶ 61,033, at P 14-16 (2004), *reh'g denied*, 110 FERC ¶ 61,285 (2005); *Portland General Elec. Co.*, 72 FERC ¶ 61,009, at 61,021 (1995).

<sup>22</sup> *Portland General Elec. Co.*, 72 FERC ¶ 61,009 at 61,021-22.

<sup>23</sup> 15 U.S.C. § 3371(a)(2).

<sup>24</sup> *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 582 (1981). The Commission has found that the filed rate doctrine applies to the generally-applicable rates approved for section 311 pipelines. *Sea Robin Pipeline Co.*, 45 FERC ¶ 61,397, at 62,252 n.5 (1988); *Prairie Producing Company v. Louisiana Intrastate Gas Corp.*, 58 FERC ¶ 61,308, at 61,987 (1992).

the right to “increase, decrease or restructure the rates (including market based rates), and Company Use charges in effect at any time,” is applicable to Florida Gas, and (2) if so, the proper interpretation of that provision. As described above, the Commission originally approved that provision as part of the 1998 settlement of Bay Gas’ filing to comply with the April 30, 1998 Certificate Order’s requirement that Bay Gas file NGPA section 311 rates for its service to Florida Gas. Thus, the applicability of Section IV of the GT&C to the contract between Bay Gas and Florida Gas turns at least in part on an interpretation of the 1998 settlement. The Commission has held that “the interpretation of a Commission-approved settlement ... is solely within the Commission’s special expertise to resolve.”<sup>25</sup>

24. In addition, the Commission has long experience interpreting contractual provisions reserving the pipeline’s right to make tariff filings proposing certain unilateral changes to a contract. Such provisions are referred to as *Memphis* clauses, after the 1958 Supreme Court decision, holding that such clauses are permissible under the NGA,<sup>26</sup> and the Commission has been called upon in numerous cases to interpret the pipeline’s authority under such clauses.<sup>27</sup> Also, because Section IV is a part of Bay Gas’ generally applicable tariff rather than a provision in a bilateral contract, there is a need for that provision to be interpreted in a uniform manner.<sup>28</sup>

25. It is also significant that Bay Gas’ tracking mechanism for recovering its LAUF costs through an in-kind fuel charge originated in the 2009 settlement approved by the

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<sup>25</sup> *Sunoco Inc. v. Transcontinental Gas Pipe Line Corp.*, 114 FERC ¶ 61,180, at P 35 (2006); *see also Nat’l Fuel Gas Supply Co. v. FERC*, 899 F.2d 1244, 1249 (D.C. Cir. 1990) (granting broad deference to Commission’s interpretation of a settlement due to its industry knowledge and exercise of its jurisdiction).

<sup>26</sup> *See United Gas Pipe Line Co. v. Memphis Light, Gas and Water Division*, 358 U.S. 103 (1958) (*Memphis*).

<sup>27</sup> *Interstate Natural Gas Ass’n of America v. FERC*, 285 F.3d 18 (D.C. Cir. 2002), *order on remand*, 101 FERC ¶ 61,127, at P 45 (2002), *order on reh’g*, 106 FERC ¶ 61,088 (2004), *aff’d sub nom. American Gas Ass’n v. FERC*, 428 F.3d 255 (D.C. Cir. 2005) (addressing challenges to the Order No. 637); *Transcontinental Gas Pipe Line Corp.*, 104 FERC ¶ 61,171 (2003), *order on reh’g*, 107 FERC ¶ 61,156 (2004), *aff’d, ExxonMobil v. FERC*, 430 F.3d 1166 (D.C. Cir. 2005).

<sup>28</sup> *Transcontinental Gas Pipe Line Corp.*, 8 FERC ¶ 61,186, at 61,647-8 (1979); *Williston Basin Interstate Pipeline Co. v. KN Energy, Inc.*, 58 FERC ¶ 61,001, at 61,003 (1992). *Compare Constellation Energy Commodities Group, Inc.*, 119 FERC ¶ 61,292 (2007) (Commission declined jurisdiction over interpretation of bilateral contract).

Commission in Docket No. PR07-9-000. Thus, resolving the issue of whether Bay Gas can assess an in-kind LAUF charge to Florida Gas also requires an interpretation of that settlement, which is a matter within the Commission's special expertise to determine.<sup>29</sup>

26. Furthermore, determining whether and how the LAUF tracking mechanism may apply to Florida Gas also requires a consideration of various Commission policies. For example, while the Commission permits a NGPA section 311 pipeline to discount the rates it charges a particular shipper below its maximum rate on file with the Commission, the Commission does not permit the pipeline to provide discounts below its variable costs, as reflected in its minimum rate.<sup>30</sup> In addition, the Commission has a longstanding policy that a pipeline's fuel costs, including its LAUF, are variable costs which cannot be discounted.<sup>31</sup> Moreover, while the Commission's negotiated rate program permits interstate pipelines to negotiate rates with shippers that are above or below the pipeline's maximum or minimum rates,<sup>32</sup> the Commission has not extended that program to NGPA section 311 pipelines.<sup>33</sup> The appropriate application of these policies to the circumstances of this case is clearly within the specialized expertise and authority of the Commission. Moreover, the consistent application of these policies is important in relation to the regulatory responsibilities of the Commission, for example to ensure against undue discrimination among shippers.

27. We therefore proceed to address the issues of (1) whether Bay Gas may assess the in-kind LAUF charge against Florida Gas as a non-discountable part of its filed rate, and (2) if so, whether other changes to Florida Gas' contract rate are necessary to maintain the economic value of its fixed discounted rate. We leave to the Texas state courts the determination of any damages to Florida Gas and resolution of any remaining issues. Once the Texas state courts have determined damages, if any, Bay Gas may ask the Commission to review the damages to determine if they violate any Commission policies

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<sup>29</sup> *Nat'l Fuel Gas Supply Co. v. FERC*, 899 F.2d 1244, 1249.

<sup>30</sup> *Northern Natural Gas Co.*, 105 FERC ¶ 61,299, at 62,442-43 (2003).

<sup>31</sup> *Mississippi River Transmission Corp.*, 98 FERC ¶ 61,119, at 61,352 (2002); *see also* 18 C.F.R. § 284.10(c)(4) (2009) (a pipeline's minimum rate must be based on the average variable costs properly allocated to the service to which the rate applies).

<sup>32</sup> *Northern Natural*, 105 FERC ¶ 61,299 at 62,442-43.

<sup>33</sup> *Northern Illinois Gas Co.*, 95 FERC ¶ 61,452, at 62,646 (2000) (finding that intrastate pipelines lack the "comparable regulatory obligations and safeguards" as interstate pipelines such that allowing negotiated rates would confer a "regulatory advantage" over comparable interstate pipelines).

under the NGA or NGPA, including those holding that rates must be between the pipeline's established minimum rate and maximum rate, or that fuel is a variable cost which may not be discounted.<sup>34</sup>

**B. The Interaction of the Firm Agreement with Bay Gas' Filed Rate**

28. Since March 9, 2007, Bay Gas' filed rates have included a tracking mechanism for the in-kind recovery of its LAUF costs, which is set forth in Section II(E) of Bay Gas' GT&C. That section contains no language exempting any shipper from paying the in-kind LAUF charge, and Commission policy prohibits the discounting of such charges. Nevertheless, Florida Gas contends that the terms of its Firm Agreement and the circumstances surrounding the original execution of that contract exempt it from any obligation to pay the in-kind LAUF charge. By contrast, Bay Gas contends that Section IV of its GT&C authorizes it to assess the new in-kind LAUF charge against Florida Gas, without any offsetting reduction in the discounted fixed rate to maintain the economic value of the parties' original bargain.

29. In the Order on Staff Panel, the Commission stated that Section IV of the GT&C appeared to constitute, in essence, a *Memphis* clause, authorizing Bay Gas to propose certain unilateral changes in contracts. However, the Commission also pointed out that a *Memphis* clause does not ordinarily authorize a pipeline to unilaterally modify a contractually agreed-upon discounted rate, at least so long as the discounted rate remains within the pipeline's maximum and minimum rates. Given the limitations of *Memphis* clause modifications to a discounted rate, the Commission asked the parties to brief whether and how the Commission's *Memphis* clause policies should be applied in this proceeding. Specifically, the Commission asked the parties to address whether GT&C Section IV should be interpreted as permitting Bay Gas "to add an in-kind LAUF charge to Florida Gas' existing discounted rate, despite the fact that rate was executed at a time when Bay Gas recovered its LAUF costs through its base rates." The Commission also requested the parties to brief several questions related to whether the contract should be modified in light of the new in-kind LAUF charge, so that Florida Gas is subject to the in-kind LAUF charge, but the existing discounted base rate is lowered so that the overall amounts paid by Florida Gas to Bay Gas are equivalent to the original contracted-for rate.

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<sup>34</sup> *Natural Gas Pipeline Co. of America*, 56 FERC ¶ 61,250, at 61,939 (1991); *Southern Union Co. v. FERC*, 857 F.2d 812, 815-16 (D.C. Cir. 1988) (finding that the Commission has authority to review damages awarded in state court litigation to determine if they violate any Federal policies).

### **Briefs**

30. Bay Gas asserts that Section IV authorizes it to seek Commission approval to restructure its discounted rates to all transportation customers, including Florida Gas. Bay Gas notes that although a *Memphis* clause generally does not authorize a pipeline to change a contractually-agreed upon discounted rate, the contractual restriction upon which this policy is based does not exist in the contract between Bay Gas and Florida Gas. Bay Gas points to three examples showing placement of the *Memphis* clause in the form of service agreement where it can be contracted away in certain cases.

31. Bay Gas further points to Section 9(i) of the Master Agreement and Section 12.2 of the Firm Agreement, as subjecting the agreements to all “present and future laws” and regulations. It also notes that Florida Gas was a party to the proceeding in which the GT&C (with Section IV) was approved. According to Bay Gas, when it filed to implement the LAUF charge, it was exercising its rights under the Master Agreement, Firm Agreement, SOC and GT&C.

32. Florida Gas asserts that Section IV is insufficient as a *Memphis* clause since under the *Mobile-Sierra* doctrine, a provision stating that the contract rates are subject to change must be contained in the contract itself.<sup>35</sup> Florida Gas further argues that the Firm Agreement does not contain any language allowing unilateral rate increases and the section cited by Bay Gas, Section 12.2, is a generic regulatory approval clause which courts have held is insufficient to be construed as a *Memphis* clause.<sup>36</sup> Further, according to Florida Gas, the *Memphis* clause may not be contained in Bay Gas’ SOC or GT&C.

33. Florida Gas further asserts that until July 2009, Bay Gas’ SOC stated that “Rates charged for services shall be negotiated between Bay Gas and Shipper.” According to Florida Gas, this sentence was deleted only when the Commission approved Bay Gas’ amended SOC and at that time, the Commission held that the deletion of the sentence was prospective.<sup>37</sup> Florida Gas argues that by stating that the deletion of the sentence was prospective in nature, the Commission “implicitly recognized” that contracts would remain valid and were in effect, grandfathered.

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<sup>35</sup> *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956); *Federal Power Commission v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956).

<sup>36</sup> Florida Gas Initial Brief at 21, citing *Texaco, Inc. v. FERC*, 148 F.3d 1091, 1096 (D.C. Cir. 1998), *aff’g Mojave Pipeline Co.*, 62 FERC ¶ 61,195 (1993), *reh’g denied*, 64 FERC ¶ 61,047, *reh’g denied*, 65 FERC ¶ 61,059 (1993).

<sup>37</sup> Florida Gas Initial Brief at 22, citing *Bay Gas Storage Co., Ltd.*, 126 FERC ¶ 61,018, at P 2 and 25 (2009).

34. In reply, Bay Gas asserts that the *Mobile-Sierra* doctrine is not applicable to section 311 pipelines since it is a product of the “just and reasonable” standard which does not exist under section 311. Further, it notes that there is no reason to conduct such an analysis since a “fixed” rate triggering applicability of *Mobile-Sierra* would be a negotiated rate, forbidden for section 311 pipelines. Further, in response to Florida Gas’ argument that the regulatory approval clause is not effective as a *Memphis* clause, Bay Gas argues that the Commission required Bay Gas to file an SOC and GT&C with the Commission and make its services conform to that SOC and GT&C.

35. Florida Gas replies that allowing Bay Gas to rely on a *Memphis* clause in its GT&C would render the *Mobile-Sierra* doctrine meaningless, since the GT&C can be changed by one party unilaterally.

### **Commission Determination**

36. For the reasons discussed below, the Commission finds that Bay Gas’ in-kind LAUF charge is a non-discountable part of Bay Gas’ filed rate which Florida Gas must pay. However, the Commission also finds that, while Section IV(A) of the GT&C authorized Bay Gas to restructure its tariff rates to include a separate LAUF tracking mechanism, Section IV(A) does not authorize Bay Gas to increase its overall rates to Florida Gas during the term of the Firm Agreement, except as necessary to ensure that Bay Gas does not discount below its minimum rate. Therefore, the Commission finds that Bay Gas must credit the value of its in-kind fuel recovery from Florida Gas toward payment of the fixed discounted rate in the Firm Agreement, so as to maintain the economic value of their bargain.

#### **1. Applicability of LAUF Charge to Firm Agreement**

37. The Commission finds that the SOC, including Sections IV(A) of the GT&C and X of the SOC, together with certain provisions of the Firm Agreement and the Master Agreement, do authorize Bay Gas to assess the in-kind fuel charge to Florida Gas, consistent with Commission policy. We recognize that Florida Gas and Bay Gas executed the original Firm Agreement and the Master Agreement before the Commission’s April 30, 1998 Certificate Order and before Bay Gas’ implementation of its SOC and GT&C. However, this fact does not insulate Florida Gas’ Firm Agreement from any unilateral changes Section IV(A) of the GT&C and Section X of the SOC may authorize Bay Gas to require.

38. Florida Gas filed the Firm and Master Agreements with the Commission as part of its application for a certificate and authorization to acquire capacity on Bay Gas. Sections 12.2 of the Firm Agreement and 9(i) of the Master Agreement provide that those contracts are subject to all applicable laws and regulations of any regulatory body having jurisdiction over Bay Gas and Florida Gas. We approved Florida Gas’ request to contract for firm service on Bay Gas’ system pursuant to the Firm Agreement, subject to the

express condition that Bay Gas provide the service to Florida Gas under section 311 of the NGPA. The Commission also specifically required Bay Gas to file a rate election or rate filing under section 284.123 of the Commission's regulations applicable to service under section 311 of the NGPA to govern its service to Florida Gas.<sup>38</sup> In compliance with that requirement, Bay Gas filed its SOC, GT&C and rate petition, and all issues concerning Bay Gas' filing were resolved by the 1999 Settlement, to which Florida Gas was a party.<sup>39</sup> As such, the Commission clearly intended that the SOC and GT&C govern Bay Gas' service to Florida Gas.

39. The Firm and Master Agreements and the original SOC agreed to by Florida Gas in the 1999 Settlement all support the conclusion that the SOC and GT&C take precedence over the Firm and Master Agreements in case of any conflict. As already described, the Master Agreement contains an express provision that it is subject to "all applicable present and future laws, rules, regulations, acts, restraints and orders of any ... regulatory ... body ... having jurisdiction over Bay Gas or [Florida Gas]" and the Firm Agreement has a similar provision. Section X of the SOC, as approved in the 1999 Settlement, provides:

This Statement of Operating Conditions, and the incorporated General Terms and Conditions [] take precedence over conflicting language in any of Bay Gas' Service Agreements or amendments thereto, unless such language specifically states that it is an exception to this Statement, and then only to the extent of such stated exception.<sup>40</sup>

40. Neither the Firm nor Master Agreements contain any such express provision, and thus the SOC and GT&C must take precedence over conflicting language in the Firm and Master Agreements. If Florida Gas had any concerns about this aspect of the SOC, it could and should have raised them in the proceeding in which the SOC and GT&C were adopted. Instead, it agreed to the 1999 Settlement approving the SOC and GT&C. In Section IV(A) of the GT&C, as approved in the 1999 Settlement Order and in effect ever since, Bay Gas specifically reserved the right "to increase, decrease or restructure the rates (including market based rates), and Company Use charges in effect at any time." Bay Gas' rates approved in the 1999 Settlement did not include any separate in-kind

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<sup>38</sup> April 30, 1998 Certificate Order, 83 FERC ¶ 61,101 at 61,487.

<sup>39</sup> *Bay Gas Storage Co., Ltd.*, 87 FERC ¶ 61,107.

<sup>40</sup> As described above, the Commission required Bay Gas to remove the "unless" clause in its January 2009 Settlement Order. However, because Bay Gas implemented the in-kind fuel charge in 2007, before elimination of the "unless" clause, we decide this case based on Section X as in effect prior to 2009.

LAUF charge. Rather, the cost of service underlying Bay Gas' maximum base rates included a component intended to recover the projected dollar amount of Bay Gas' LAUF costs. However, we interpret Section IV(A) as reserving a right for Bay Gas to remove fuel and LAUF costs from its base rates and, instead, impose a separate in-kind charge to recover such costs. This follows from the fact that Section IV(A) provides that Bay Gas may not only increase or decrease its rates, but also may "restructure" its rates, including "Company Use charges." Because Bay Gas had no "Company Use charges" when the SOC and GT&C were adopted in 1999, the only purpose for including a reference to such charges would have been to authorize the creation of such charges in the future.

41. In 2007, Bay Gas exercised the right reserved in Section IV(A) of the GT&C to restructure its rates by proposing in Docket No. PR07-9-000 to remove LAUF costs from the cost of service underlying its base rates and instead to recover such costs through a separate tracking mechanism. It proposed to include the tracking mechanism in Section II(E) of its GT&C. In the January 2009 Settlement Order, the Commission approved this proposal, as modified in an uncontested settlement. Florida Gas did not oppose the settlement.

42. Because the tracking mechanism is included in Bay Gas' GT&C, Section X of Bay Gas' SOC provides that it takes precedence over any conflicting provision in Bay Gas' service agreement, including Florida Gas' Firm Agreement. Therefore, to the extent there is any conflict between the provisions of the LAUF tracking mechanism in Section II(E) of the GT&C and the provisions of Florida Gas' Firm Agreement that Bay Gas will redeliver gas containing an equal quantity of Btu as Florida Gas delivered to it,<sup>41</sup> and that the risk of loss be on the party having possession of the gas,<sup>42</sup> the LAUF tracking mechanism must prevail over the provisions of the Firm Agreement.

43. We conclude that Bay Gas may assess its in-kind LAUF charge to Florida Gas, as an approved part of Bay Gas' filed rate applicable to all of Bay Gas' customers. This conclusion is consistent with the Commission's longstanding policy that a pipeline's fuel costs, including its LAUF, are variable costs which cannot be discounted.<sup>43</sup> It is also consistent with the Commission's policy that NGPA section 311 pipelines cannot

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<sup>41</sup> Firm Agreement § 2.1.

<sup>42</sup> Firm Agreement §13.3.

<sup>43</sup> *Mississippi River Transmission Corp.*, 98 FERC ¶ 61,119, at 61,352; *see also* 18 C.F.R. § 284.10(c)(4).

negotiate rates with individual shippers that are above the pipeline's maximum rate or below the minimum rates on file with the Commission.<sup>44</sup>

## 2. Maintenance of Economic Value of Firm Agreement

44. In the preceding section, we have interpreted Section IV(A) of Bay Gas' GT&C as permitting Bay Gas to remove fuel and LAUF costs from its base rates and, instead, impose a separate in-kind charge to recover such costs. Bay Gas contends that not only does Section IV(A) authorize it to establish an in-kind LAUF charge, it permits Bay Gas to add the in-kind fuel charge onto the existing rates it charges Florida Gas, without any adjustment to the preexisting fixed dollar charge in its Firm Agreement with Florida Gas. We disagree.

45. Section IV(A) of the GT&C constitutes, in essence, a *Memphis* clause, authorizing Bay Gas to propose certain unilateral changes in contracts. However, a *Memphis* clause does not ordinarily authorize a pipeline to unilaterally modify a contractually agreed-upon discounted rate, so long as the discounted rate remains within the pipeline's maximum and minimum rates. Rather, *Memphis* clauses are limited to authorizing a pipeline to file with the Commission to modify the generally applicable maximum and minimum rates and other terms and conditions set forth in its tariff. *Memphis* clauses do not authorize the pipeline to make unilateral changes in the individually negotiated provisions of a particular service agreement, such as a customer's discounted rate or contract demand.<sup>45</sup>

46. We interpret Section IV(A) in light of this consistent practice concerning the changes authorized by a typical *Memphis* clause, absent a clear indication in the language of Section IV(A) of an intent to authorize unilateral changes beyond those usually authorized by a *Memphis* clause. Section IV(A) contains no express reference to changing individually agreed-upon rates in particular service agreements. Rather, it reserves a right "to increase, decrease or restructure the rates (including market based rates), and Company Use charges in effect at any time." We interpret this language to refer only to the generally applicable rates set forth in Bay Gas' tariff.

47. This case does involve a relatively unusual situation of a pipeline not simply increasing or decreasing the maximum and minimum rates in its tariff, but restructuring those rates to remove one cost-item (LAUF) that was previously included in the pipeline's base rates and shifting that cost item to a separate, in-kind charge in the tariff.

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<sup>44</sup> *Northern Illinois Gas Co.*, 95 FERC ¶ 61,452 at 62,646.

<sup>45</sup> *Transcontinental Gas Pipe Line Corp.*, 104 FERC ¶ 61,171 (2003), *order on reh'g*, 107 FERC ¶ 61,156 (2004), *aff'd*, *ExxonMobil v. FERC*, 430 F.3d 1166, 1173.

However, Section IV(A)'s very use of the term "restructure" suggests that such a change was not intended to authorize an overall rate increase, but simply a shifting of particular cost items among the different components of the overall rate.

48. In this case, until Bay Gas proposed to implement a tracker to recover its cost of LAUF on an in-kind basis, the cost of service underlying Bay Gas' maximum base rates included a component intended to recover the projected dollar amount of Bay Gas' LAUF costs.<sup>46</sup> Ordinarily, when a pipeline increases its maximum rates to reflect cost increases, it must continue to abide by any contractual agreements with individual customers to provide service at fixed, discounted rates. Therefore, if Bay Gas had proposed to continue to recover its LAUF costs through its base rates, it would not have been entitled to increase its discounted rates to recover any increase in the dollar amount of its LAUF costs. The fact that Bay Gas has instead removed its LAUF costs from its maximum base rates and shifted them to a separate surcharge does not justify a different result in this case.

49. Because the discounted rate in this contract was agreed to at a time when Bay Gas' maximum base rates were designed to recover its LAUF costs, the discounted rate must have been intended to include any payment Florida Gas would make to Bay Gas to cover its LAUF costs. In fact, requiring Florida Gas to now pay a surcharge for LAUF costs, in addition to the existing agreed-upon discounted base rates, would impermissibly increase its contractually agreed-upon rates.

50. We also find significant that Bay Gas agreed to roll over the Firm Agreement at the rate set forth by Florida Gas, without mention of the LAUF charge or need to recover fuel costs. As noted above, on November 26, 2007, Florida Gas sent a letter to Bay Gas exercising its right to roll-over the Firm Agreement for an additional ten-year term. In that letter, Florida Gas specified that it wished to roll-over an MDTQ of 32,000 MMBtu/day at a rate of \$0.029 per MMBtu. Bay Gas counter-signed the letter and acknowledges that the letter was sufficient to effectuate Florida Gas' roll-over rights. At the time of the roll-over, Bay Gas had already filed its proposal to establish the LAUF tracker. When it received this letter, Bay Gas had the opportunity to assert to Florida Gas that the rate it will be paying during the roll-over term will include a LAUF charge, or otherwise alter or re-negotiate the rate Florida Gas set forth to take LAUF into account. Bay Gas did not do this; rather, it simply counter-signed the letter and accepted Florida

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<sup>46</sup> See Bay Gas Storage Co, Ltd., Petition for Rate Approval for Transportation of Natural Gas Under NGPA section 311 at 11, Docket No. PR07-9-000 (Mar. 8, 2007) ("In its previous rate cases, Bay Gas has included LAUF volumes costs in the cost of service.").

Gas' roll-over.<sup>47</sup> We therefore find that the rate set forth in the November 26, 2007 letter represents the rate under the Firm Agreement as extended until November 30, 2018.

51. The Commission sees no reason to permit Bay Gas to unilaterally modify its contractual commitment to provide service to Florida Gas under discounted fixed rates, so long as the discounted rate remains within Bay Gas' generally applicable maximum and minimum rates. Bay Gas entered into these arrangements freely, and cannot now escape the benefit of the bargain that it granted Florida Gas in the discount rate Firm Agreement.<sup>48</sup>

52. We therefore find that Bay Gas may collect the in-kind LAUF charge from Florida Gas, to ensure that it recovers its variable costs. However, Bay Gas must credit back to Florida Gas the monetary value of the LAUF charge, up to the amount paid by Florida Gas under the Firm Agreement. In this way, Florida Gas will retain the economic value of its bargain, subject only to the requirement that it always pay at least Bay Gas' variable fuel cost, consistent with Commission policy. We direct Bay Gas to file, within 90 days of this order, a mechanism whereby it will implement such crediting. Further, if the damages awarded by the state court implicate Commission regulations regarding discounting of variable costs and prohibited negotiated rates, then Bay Gas may file for Commission review of such damages.<sup>49</sup>

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<sup>47</sup> Florida Gas asserts that it became aware of Bay Gas' withholding in March 2008 and notified Bay Gas that such withholding was improper under the Firm Agreement. According to Florida Gas, the approximate value of the gas withheld from March 2007 through December 2009 exceeds \$790,000. Florida Gas Initial Brief at 7-8.

<sup>48</sup> See, e.g., *Associated Gas Distributors v. FERC*, 824 F.2d 981, 1016 (D.C. Cir. 1987) (holding that, in the context of reviewing a modification of contracts for NGPA section 311 service, "unilateral abrogation of a contract is an extreme measure").

<sup>49</sup> *Southern Union Co.*, 857 F.2d 812, 815-16.

The Commission orders:

Bay Gas is directed to file a compliance filing within 90 days of the date of this order, as discussed in the body of this order.

By the Commission.

( S E A L )

Kimberly D. Bose,  
Secretary.