UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Southern LNG Inc. Docket No. CP99-579-003

ORDER ON COMPLIANCE AND INITIATING A
PROCEEDING UNDER SECTION 5 OF THE NATURAL GAS ACT

(Issued February 11, 2005)

1. On December 1, 2004, Southern LNG Inc. (SLNG) filed a cost and revenue study to justify its existing LNG storage rates at the reactivated Elba Island LNG terminal in compliance with the Commission's December 22, 1999 Order.[1] The Commission sets the cost and revenue study for hearing under section 5 of the Natural Gas Act (NGA) to determine if the current LNG storage rates remain just and reasonable, but will hold the hearing in abeyance pending the establishment of settlement judge procedures. This order benefits the public by ensuring that the existing LNG storage rates are just and reasonable.

Background

2. Ordering Paragraph (E)(1) of the December 22, 1999 Order conditioned approval of SLNG's plan to reactivate the Elba Island terminal on SLNG filing information in the form specified by section 154.313 of the Commission's regulations[2] after three years of service. To comply with the condition, SLNG has filed the cost and revenue information after three years of operations of the reactivated Elba Island LNG terminal, which commenced service on December 1, 2001.[3] SLNG claims that the filing supports not

[1] *Southern LNG Inc.*, 89 FERC ¶ 61,314 (1999).

[2] 18 C.F.R. § 154.313 (2004).

[3] The cost of service addresses the base rates, which are exclusive of any surcharges, such as for maintenance dredging, fuel, electricity, and ACA.

changing the currently effective base reservation charge for LNG storage and the base commodity rate for delivery of regasified LNG, which resulted from the August 10, 2002 Stipulation and Agreement (S&A) that became effective on March 1, 2002.[4]

3. SLNG asserts that the $36,584,296 cost of service in the cost and revenue study exceeds the $34,756,464 cost of service underlying its currently effective rates, however, SLNG does not propose an increase in rates to recover the higher proposed cost of service level. Conversely, SLNG claims that it does not believe that a decrease in rates is justified for three reasons: (1) the current depreciation rate of 1.76 percent will not recover the cost of plant during the primary term of SLNG's only firm service agreement with BG LNG Services LLC (BGLS), (2) the rate of return on equity (ROE) of 12.5 percent underlying the current rates falls below the capital cost set by the market, and (3) it is improving the LNG infrastructure at Elba Island, including modifications that respond to Staff's findings on the explosion at Skikda, Algeria, measures that comply with new security plans approved by the U.S. Coast Guard, and an expansion that will increase the capacity, reliability, safety, and security of terminal service.[5]

4. The $36,574,296 total cost of service in the cost and revenue study is comprised of $11,615,911 of operation and maintenance (O&M) expenses, $6,474,543 of depreciation and amortization expenses, $11,945,434 of return on rate base, $4,426,833 of federal income taxes, $807,325 of state income taxes, and $1,304,250 of taxes other than income taxes. The total rate base of $106,560,514 consists of $231,593,472 of gas plant, less $110,979,027 of accumulated depreciation and amortization, $15,700,086 of accumulated deferred income taxes, plus $1,646,156 of working capital.

5. SLNG indicates that it has used the capital structure (49.28 percent debt and 50.72 percent equity) and debt cost (8.2 percent) of its parent, Southern Natural Gas Company (Southern) in the cost and revenue study, because Southern provides the financing for SLNG. SLNG states that it does not issue its own debt and does not have a separate bond rating. SLNG reflects a 14.14 percent ROE, and an overall cost of capital of 11.21 percent in the cost and revenue study, and also uses a depreciation rate of 2.84 percent. SLNG emphasizes, however, that it is not proposing to change the ROE and depreciation rate approved by the Commission.

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[4] *Southern LNG Inc.*, 101 FERC ¶ 61,009 (2002).

[5] SLNG states that the filing does not include costs or revenues for the Elba Island LNG terminal expansion, which will not begin service until 2006. The expansion was approved by the Commission in *Southern LNG Inc.*, 101 FERC ¶ 61,187 (2002), *reh'g* 103 FERC ¶ 61,029 (2003).

6. SLNG claims the cost and revenue study uses the same cost classification, cost allocation, and rate design methods underlying the current rates, and that it uses the same reservation billing determinants for LNG storage in this cost and revenue study. SLNG states the commodity billing determinants are unadjusted base period numbers.[6]

Notice, Interventions and Protests

7. Notice of SLNG's filing was issued on December 10, 2004 with protests due on or before December 16, 2004, and was published in the *Federal Register* on December 17, 2004 (69 Fed. Reg. 75,524 (2004)). Timely protests were filed by Marathon LNG Marketing LLC (Marathon LNG) and Shell NA LNG LLC (Shell LNG), which are more fully described below. Motions to intervene were filed by Marathon LNG, Shell LNG, BGLS, TRINLING Ltd., and Port Fortin LNG Exports Ltd. The Commission finds good cause to grant the interventions.

8. On January 5, 2005, SLNG filed an answer to the protests. On January 19, 2005, Marathon LNG filed a motion to strike SLNG's answer, or in the alternative, an answer responding to SLNG's answer. We dismiss Marathon LNG's motion to strike SLNG's answer, and instead allow both the SLNG and Marathon LNG answers. Although our rules prohibit answers, we may for good cause waive this provision.[7] We find good cause to do so in this instance since admitting the pleadings will not cause undue delay and will insure a complete record in this proceeding. The SLNG and Marathon LNG answers are also discussed below.

A. Marathon LNG's Protest

9. Marathon LNG protests the filing stating that SLNG's rate justification is premised on major adjustments to the cost of service, and without the adjustments, Marathon LNG states SLNG would require a rate decrease.[8] The issues raised by Marathon LNG include: 1) SLNG increasing the depreciation rate from 1.76 percent to 2.84 percent, (2) increasing the ROE from 12.5 percent to 14.14 percent, (3) new assets included in rate base, such as infrastructure modifications, new security measures, and an expansion, and finally, (4) changes to the debt/equity ratio of SLNG's capital structure from the percentages of 41/59 to 49.28/50.72. Marathon LNG requests that the Commission convene a technical conference on SLNG's rate justification filing.

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[6] The base period of the cost and revenue study consists of the twelve months ended July 31, 2004.

[7] *See* 18 C.F.R. §385.213(a)(2)(2004).

[8] Marathon LNG states the actual cost of service is more than $4 million less than the cost of service underlying the current rates.

B. Shell LNG's Protest

10. Shell LNG protests that the cost and revenue study does not demonstrate that SLNG's current rates are just and reasonable. Further, Shell LNG states that SLNG has not adequately explained its increased ROE and associated income taxes, the proper parent company capitalization, and has not justified its increased depreciation rates, operations and maintenance expenses, and use of base period billing determinants. Shell LNG states that if SLNG had used its existing ROE and depreciation rate to calculate its cost of service, the cost of service would be significantly lower.

11. Shell LNG disputes SLNG's claim that it faces commercial and operational risks not shared by the average pipeline. Specifically, Shell LNG takes issue with SLNG's claims of increased risks due to having one contract for firm services, being limited to receipts from LNG tankers rather than a range of receipt points, and operating subject to heat rate consideration for the LNG it receives. Among other things, Shell LNG points out that SLNG has contracted the full capacity of the existing terminal for 22 years, and that SLNG will enjoy the benefits of the anticipated terminal expansion which is fully contracted for 30 years with Shell LNG. Shell LNG states that the cost and revenue study raises numerous questions that warrant further consideration, citing *Maritimes and Northeast Pipeline, L.L.C. (Maritimes),* 100 FERC ¶ 61,066 (2004), regarding the Commission order that set a pipeline's filing of a cost and revenue study for hearing.

C. SLNG's Answer to Protests

12. SLNG states that the cost and revenue study satisfies the certificate condition because it provides all of the information required in section 154.313 of the Commission's regulations and follows the methodologies underlying the initial rates. SLNG reiterates that it does not propose any change to the depreciation rates, billing determinants, the ROE or any other component of the current rates, and moreover, it has not included expansion costs or revenues in the study. SLNG emphasizes that it does not propose any change to the current rates which were placed into effect on March 1, 2002 by the Commission approved S&A.

13. SLNG questions the standing of Marathon LNG and Shell LNG in this proceeding. SLNG states that it provides firm service to only one shipper, BGLS and that neither Marathon LNG nor Shell LNG receives service from SLNG at the jurisdictional rates. SLNG states that Marathon LNG has a nonjurisdictional contract with BGLS to sell and repurchase LNG volumes. SLNG also notes that Shell LNG has subscribed to firm service from an expansion authorized on April 10, 2003,[9] that has a planned in-service date of February 1, 2006.

[9] *Southern LNG Inc.*, 101 FERC ¶ 61,182 (2002), *reh'g* 103 FERC ¶ 61,029 (2003).

14. SLNG further argues that the reasonableness of its current rates and of the Commission's review of those rates should acknowledge the lighter-handed regulation of LNG terminals accorded under the *Hackberry* policy,[10] and that imposing additional regulatory burdens on SLNG by initiating a technical conference or NGA section 5 investigation of the current rates contradicts the Commission's policy of ensuring efficiency in the LNG market by removing regulatory burdens. However, SLNG acknowledges that it has not yet sought to adopt the *Hackberry* policy for Elba Island.

15. SLNG further attempts to differentiate itself from the NGA section 5 treatment in *Maritimes* for the following asserted reasons: (1) SLNG's project costs and initial rates have already been litigated and settled through several orders in Docket No. RP02-129, (2) neither Shell LNG or Marathon LNG asserts or substantiates the need for a hearing under section 5 of the NGA, (3) the rate issues in SLNG's expansion fall far outside the test period for this study and were fully reviewed through both preliminary determination and rehearing orders in Docket No. CP02-379, and (4) heavy-handed regulation of SLNG's rates cannot square with the Commission's lighter-handed regulation of LNG terminals.

D. Marathon LNG's Answer to SLNG's Answer

16. Marathon LNG asserts that on the basis of the minimal information that was provided, it is not possible to determine whether the current LNG storage rates are justified. Marathon LNG requests a technical conference to enable SLNG to provide further support for its existing rates, but if SLNG is unable to provide further supporting information at the technical conference, Marathon LNG asks the Commission to set the matter for hearing.

17. Marathon LNG asserts that it has standing to question the rates charged to BGLS given Marathon LNG's obligation under its legally binding contract with BGLS to pay a significant portion of the terminal charges charged by SLNG to BGLS.[11] Marathon LNG also argues that the Commission's rate justification requirement is meaningless, because in using SLNG's approach, every rate regulated entity will be able to show a deficiency in revenues under its existing rates if it can simply alter the rate of return, capital structure used, and the depreciation rates to produce a higher cost of service. Moreover, Marathon LNG states that SLNG's filing includes testimony and exhibits sponsored by witnesses that no party has had an opportunity to question or cross-examine.

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[10] *Hackberry LNG Terminal, LLC*, 101 FERC ¶ 61,294 (2002), *reh'g* 104 FERC ¶ 61,269 (2003) (*Hackberry*).

[11] *See Southern LNG Inc.*, 103 FERC ¶ 61,029 (2003) at P 28 ("Marathon LNG has financial interests that may be affected by the outcome of proceeding").

18. Marathon LNG additionally points out that SLNG proposes that the Commission forego any scrutiny of its rates, even though it has not proposed to adopt the *Hackberry* policy and despite the existing certificate condition that requires SLNG justify its rates. Marathon LNG also argues that while SLNG did not file a rate increase, it did calculate an entirely new cost of service using new components to justify its existing rates which requires scrutiny, even if SLNG did not ask to place the new cost of service rates into effect. Finally, Marathon LNG claims that it is not clear that expansion costs have not been included in calculating the cost of service.

Discussion

A. Standing

19. The Commission finds that Marathon LNG has shown that it has a sufficient economic interest in this proceeding to permit its intervention. Even though BGLS holds 100 percent of the existing capacity at Elba Island, Marathon's contract with BGLS requires it to reimburse BGLS for a significant portion of the Elba Island terminalling costs, both fixed and variable, that BGLS pays to SLNG. These costs must be paid by Marathon LNG without regard to volumes delivered. As such, Marathon LNG is directly affected by the terminalling charges assessed to BGLS. This finding is consistent with the finding in *Southern LNG Inc.*, 103 FERC ¶ 61,029 (2003) at P 28, where the Commission found that Marathon LNG has a financial interest that may be affected by the outcome of that proceeding.

20. We also find that Shell LNG has a financial interest in this proceeding since the rates resulting from this proceeding can reasonably be expected to be charged to Shell LNG at the time of the commencement of the service expansion. Shell LNG is the expansion shipper at the Elba Island LNG terminal and has contracted for all of the additional capacity for a term of 30 years. Although service to Shell LNG is not expected to commence until 2006, the LNG storage rates resulting from the outcome of this proceeding directly affect Shell LNG because the Commission has previously granted SLNG a predetermination supporting a presumption that SLNG will be allowed to roll in expansion costs into its existing rate base in a future rate case.[12] The Commission's conclusion to roll in the expansion costs was based on what was known and reasonably expected concerning the proposed expansion costs and revenues, and SLNG has not asserted that there has been any change that might affect the basis for the Commission's presumption supporting rolled-in rate treatment.

[12] *Southern LNG Inc.*, 101 FERC ¶ 61,187 (2002), *reh'g* 103 FERC ¶ 61,029 (2003) ("approving presumption of rolled-in rate treatment of Elba Island LNG terminal expansion").

B. Hearing

21. SLNG disagrees with Shell LNG that a NGA section 5 proceeding is appropriate to review its cost and revenue study, such as the Commission ordered in *Maritimes*. SLNG claims that its project costs and initial rates have already been litigated and settled, the need for a hearing under section 5 of the NGA has not been substantiated, the rate issues in SLNG's expansion fall far outside the test period and were already reviewed by the Commission, and the Commission's should provide lighter-handed regulation to LNG terminals.

22. The Commission is not persuaded by SLNG's arguments. The Commission required SLNG through a certificate condition to justify its existing LNG storage rates and that entails reviewing all aspects of its cost and revenue study. The fact that SLNG has not proposed a change in rates does not diminish the requirement that SLNG justify the basis and assumptions used in its cost and revenue study. In this regard, Marathon LNG and Shell LNG have raised several concerns relating to SLNG's cost and revenue study involving material issues of fact which potentially could result in a decrease to SLNG's current LNG storage rates. Additionally, SLNG is requesting that the Commission afford it lighter-handed regulation, however, SLNG has not sought *Hackberry* treatment for the Elba Island LNG terminal.

23. Therefore, the Commission finds that all issues concerning SLNG's cost and revenue study should be explored at the hearing established by this order under section 5 of the NGA. The Commission will set the matter for hearing; however, the Commission will hold the hearing in abeyance pending settlement judge procedures to provide the parties an opportunity to resolve their differences.

The Commission orders:

(A) Pursuant to the authority of section 5 of the NGA, and the Commission's rules and regulations, a public hearing will be held in this proceeding concerning SLNG's filed cost and revenue study and the just and reasonableness of SLNG's currently effective LNG storage rates, however, the Commission will hold the hearing in abeyance pending the outcome of settlement judge procedures.

(B) Pursuant to Rule 603 (18 C.F.R. §385.603 (2004)) of the Commission's Rules of Practice and Procedure, the Chief Administrative Law Judge is directed to appoint a Settlement Judge within 10 days of the issuance of this order. The Settlement Judge shall convene an initial settlement conference as soon as practicable.

(C) Within 45 days of the issuance of this order, the Settlement Judge shall report to the Commission and the Chief Administrative Law Judge on the status of the negotiations. If settlement is likely, as concurred in by SLNG, Marathon LNG, and Shell

LNG, and interested parties, further negotiations may be approved for a period of 30 days by the Chief Administrative Law Judge. The Settlement Judge shall report to the Commission and to the Chief Administrative Law Judge as soon as possible upon conclusion of such further 30 day period.

(D) If settlement discussions fail, a Presiding Administrative Law Judge shall assure expeditious litigation of the matters set for hearing. The Chief Administrative Law Judge shall appoint a Presiding Administrative Law Judge who shall convene a pre-hearing conference within 15 days of the date of the settlement judge's final report.

By the Commission.

(S E A L)

Linda Mitry,
Deputy Secretary.