UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Burlington Resources Oil & Gas Company	Docket No. GP99-15-003
Panhandle Eastern Pipe Line Company	Docket No. RP98-40-039

ORDER ON REMAND

(Issued July 8, 2005)

1. In this order the Commission addresses the remand by the United States Court Of Appeals for the District of Columbia Circuit, *Burlington Resources Oil & Gas Company v. FERC (Burlington Resources)*.[1] The Commission explains why there is no inconsistency in the Commission's approval of "Omnibus" *ad valorem* settlements, and its refusal to permit a producer to rely on "indemnity" clauses in take or-pay settlements to relieve that producer of its *ad valorem* refund obligation, and reaffirms the prior decision to require Burlington Resources Oil and Gas Co. (Burlington)[2] to pay its *ad valorem* refund obligation.

I. **Background**

2. In *Public Service Company of Colorado v. FERC* (*Public Service*)[3] the Court upheld the Commission's decision that Kansas *ad valorem* taxes were improperly added to the maximum lawful prices (MLP) under the Natural Gas Policy Act (NGPA), and

[1] 396 F.3d 405 (D.C. Cir. 2005).

[2] Burlington was the successor of Southland Royalty Company which had the gas purchase contract with those pipelines. This order will refer to Burlington in all instances.

[3] 91 F.3d 1478 (D.C. Cir. 1996), *cert. denied*, 520 U.S. 1224 (1997).

ordered first sellers/producers to make refunds of *ad valorem* taxes collected beginning in October 1983.[4] On September 10, 1997, the Commission issued an order (Procedural Order) implementing the *Public Service* decision.[5] The Procedural Order established procedures and timetables for producers to make refunds to the pipelines, and for the pipelines to flow the refunds through to their customers. The Court affirmed the Commission in *Anadarko Petroleum Co. v. FERC*.[6]

3. In compliance with the 1997 Procedural Order, each pipeline that had paid the *ad valorem* add-on taxes sent statements of refunds due to producers and working interest owners (WIO). Each pipeline sent hundreds of refund statements to producers and WIOs. Many producers disputed the claims against them and filed numerous petitions for adjustments or other relief from the asserted *ad valorem* refund obligations. In an effort to resolve the disputes over the amount of the refund obligation, representatives of the various interests participated in extensive settlement discussions, which were facilitated by the Commission's Dispute Resolution Service. These discussions led to settlements with every pipeline. The settlements that were achieved were submitted to the Commission for its approval under Rule 602 of the Commission's regulations governing settlement offers.

4. Panhandle Eastern Pipe Line Co. (Panhandle) and Northern Natural Gas Co. (Northern) had sent a statement of refunds due to Burlington. In Docket No. GP99-15-000, and Docket No. SA99-1-000, Burlington denied any liability for these *ad valorem* claims. Subsequently Panhandle and Northern entered into settlement agreements approved by the Commission (the Omnibus Settlement). After Burlington opted out of these settlements, the Commission set these claims against Burlington for hearing. Burlington contended that it was not liable for any *ad valorem* refund because it had entered into earlier settlements with Panhandle and Northern which included an indemnity clause. Burlington asserted that although the amount of the *ad valorem* refund claim each pipeline asserted against it was correct, the indemnity clause relieved it of any *ad valorem* refund liabilities, and each pipeline was responsible for payment of the

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[4] The Commission had required refunds commencing in June 1988. The Court's decision extended the period when refunds were due from 1983 to 1988.

[5] *Public Service Co. of Colorado, et al.*, 80 FERC ¶ 61,264 (1997), *reh'g denied*, 82 FERC ¶ 61,058 (1998).

[6] 196 F.3d 1264, *reh'g*, 200 F.3d 867 (D.C. Cir.), *cert. denied*, 147 L Ed.2d 248 (June 6, 2000). The Court also agreed with the Commission's ruling as to what taxes were covered.

refund. The Commission rejected Burlington's defense holding that the NGPA prohibited a producer from receiving more than the MLP. The Commission held that the "indemnity" clause Burlington relied upon cannot relieve the producer from paying the refund when it receives more than the MLP in a first sale.[7]

II. <u>The Court's Opinion</u>

5. The Court stated that the Commission had rejected Burlington's argument that the indemnity clause relieved it of the *ad valorem* refund obligation because the NGPA bars a producer from retaining amounts received in excess of the ceiling prices, and Burlington's reading of the indemnity clauses would allow Burlington to retain such excess amounts.

6. The Court was troubled with the apparent inconsistency it found between the Commission's rejection of Burlington's indemnification clause to relieve it of its *ad valorem* liability, and the Commission's approval of Panhandle and Northern's "Omnibus Settlements." Those settlements reduced or eliminated *ad valorem* refund claims against some producers. The Court observed, among other things, that the Commission had distinguished its approval of the Omnibus Settlements as: (1) involving producers who agreed to immediate payment of a substantial part of the disputed refunds, whereas Burlington sought to be relieved of all refund liability; and (2) including customers as well as pipelines and producers as parties to the settlement, while the Burlington settlements were between it and the pipelines only.

7. The court found those arguments, as well as two other Commission cases cited as precedent for denying transfer of *ad valorem* refund liability, not dispositive. Moreover, the "Commission's position that its encouragement of settlement of take-or-pay liability did not intend for NGPA ceiling prices to be exceeded begs the question of how it could approve the Omnibus Settlement Agreements, although such settlements would likewise violate section 504(a) of the NGPA under the Commission's interpretation here."[8]

8. The crux of the Court's remand decision was that by approving the Omnibus Settlements under the mantle of "prosecutorial discretion" the Commission "betrays a

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[7] *Burlington Resource Oil and Gas Co.*, 103 FERC ¶ 61,005, *reh'g denied*, 104 FERC ¶ 61,317 (2003), and *Panhandle Eastern Pipe Line Co.*, 103 FERC ¶ 61,007, *reh'g denied*,105 FERC ¶ 61,141 (2003).

[8] 396 F.3d at 411.

recognition that section 504 of the NGPA does not render unlawful all private agreements allowing a producer to retain funds collected pursuant to unlawfully high prices."[9]

9. The Court also questioned why "in light of the substantial consideration paid by Burlington in part for release and indemnification by Northern and Panhandle for all claims arising from the take-or-pay contracts, it refused to exercise its prosecutorial discretion to give effect to the release and indemnity clauses in the 1989 and 1992 Settlement Agreements."[10]

10. The Court remanded with the caveat "we do not decide whether there could be a legally relevant distinction between the Northern and Panhandle Settlement Agreements and the Omnibus Settlement Agreements."[11]

III. Discussion

11. The Commission reaffirms its decision to require Burlington to refund to Northern and Panhandle the *ad valorem* tax reimbursements it collected from them and to not enforce the release and indemnity clause in Burlington's take-or-pay 1989 and 1992 settlement agreements. For the reasons discussed below, the Commission finds that there are significant differences between the "settlement agreements" Burlington relies upon, and the Omnibus Settlements entered into by Panhandle and Northern to resolve the outstanding *ad valorem* refund claims against hundreds of producers, which justify the Commission's differing actions with respect to each.

12. The Commission has held, and the Court in *Public Service* has affirmed, that producers' collection of Kansas *ad valorem* tax reimbursement from pipelines violated the MLP established by the NGPA, and the Court ordered the Commission to require producers to refund those amounts to the pipeline. Thus, both the proceedings resolved by the Omnibus Settlement, and the Burlington proceedings involve enforcement of the NGPA's maximum lawful prices. Before explaining the reasons for our actions in these enforcement proceedings, we shall set forth the general principles governing our administration of the NGPA ceiling prices.

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[9] *Id*.

[10] *Id.*

[11] *Id.* at 412.

13. First, the NGPA rendered illegal and unenforceable all private contracts between the seller and purchaser in first sales which required the purchaser to pay in excess of the statutorily mandated maximum ceiling prices set forth in the NGPA.[12] Section 504(a) provided, "It shall be unlawful for any person to sell natural gas at a first sale price in excess of any applicable maximum lawful price under" the NGPA. Moreover, the United States Court of Appeals for the District of Columbia Circuit has found that the filed rate doctrine set forth by the Supreme Court in *Arkla v. Hall*, 453 U.S. 571 (1981) (*Arkla*), applies not only to rates for services subject to the Commission's NGA jurisdiction, such as were at issue in *Arkla*, but also to the maximum lawful prices established by the NGPA. *Southern Union Gas Co. v. FERC*, 857 F.2d 812, 817 (D.C. Cir. 1988) (*Southern Union*).

14. In *Arkla*, the Supreme Court held that "to permit parties to vary by private agreement the rates filed with the Commission would undercut the clear purpose of the congressional scheme: granting the Commission an opportunity in every case to judge the reasonableness of the rate."[13] In the context of the NGPA, permitting parties to vary, or exceed, by private contract the maximum rates established by Congress would even more directly undercut the clear purpose of the Congressional scheme, since Congress declared any rates in excess of the maximum rates established by the NGPA to be unlawful. Moreover, in *Arkla*, the Supreme Court held, "Not only do the courts lack authority to impose a different rate than the one approved by the Commission, but the Commission itself has no power to alter a rate retroactively."[14] Under the NGPA, the Commission's authority is even more limited, since it lacks authority to modify the NGPA ceiling prices even prospectively.[15]

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[12] *Public Service Commission of New York v. Mid-La Gas Co.*, 463 U.S. 319, 334 (1983) ("The statute replaces the Commission's authority to fix rates of return to gas producers according to what is 'just and reasonable' with a precise schedule of price ceilings.")

[13] 453 U.S. at 582.

[14] *Id*. at 578.

[15] NGPA sections 104(b)(2), 106(c) and 109(b)(2) gave the Commission authority to increase the sections 104, 106, and 109 ceiling prices based on a finding that the increased ceiling price was just and reasonable under the NGA. However, those sections are not relevant in the current context.

15. In administering the NGPA, the Commission does have available to it two limited avenues to permit a first seller to retain amounts unlawfully collected in excess of NGPA ceiling prices: (1) prosecutorial discretion not to bring an enforcement action with respect to a particular violation of the act, and (2) a grant of adjustment relief under NGPA section 502(c).

16. The Commission's prosecutorial discretion with respect to enforcement of the NGPA maximum lawful prices arises from NGPA section 501(a), providing for the Commission to administer the NGPA. That section provides, "The Commission . . . is authorized to perform any and all acts (including any appropriate enforcement activity) . . . as it may find necessary or appropriate to carry out its functions under this Act." The Commission believes that the authorization to perform "appropriate enforcement activity" carries with it the usual prosecutorial discretion that any regulatory agency has in determining what actions to take to enforce a statute, when it believes a person has or is violating the statute. In addition NGPA section 504 (b)(1) provides that the Commission "may bring an action in a United States District Court … to enforce compliance with this Act…."[16]

17. The Commission's prosecutorial discretion not to prosecute arises primarily from the fact that it has limited resources and must therefore decide how best to deploy those resources to carry out Congress's objectives to the maximum extent possible with the resources available to it. The Supreme Court in *Heckler v. Chaney*, 470 U.S. 821 (1985) (*Heckler*), upheld an administrative agency's refusal to exercise its enforcement authority, or its exercise of that authority in a particular way, and referred to the conservation of resources as one of the reasons why administrative agencies are granted such prosecutorial discretion. The Court stated:

> First, an agency decision not to enforce often involves a complicated balancing of a number of factors which are peculiarly within its expertise. Thus, the agency must not only assess whether a violation has occurred, but whether agency resources are best spent on this violation or another, whether the agency is likely to succeed if it acts, whether the particular enforcement action requested best fits

[16] In *Baltimore Gas and Electric Company v. FERC* , 252 F.3d 456, 460-61 (D.C. Circuit 2001), the Court interpreted similarly broad language in the Natural Gas Act (NGA) as giving the Commission prosecutorial discretion in the Commission's enforcement of the NGA.

> the agency's overall policies, and, indeed, whether the agency has enough resources to undertake the action at all. An agency generally cannot act against each technical violation of the statute it is charged with enforcing. The agency is far better equipped than the courts to deal with the many variables involved in the proper ordering of its priorities.[17]

18. Consistent with *Arkla,* the Commission does not view its prosecutorial discretion as including a positive right to approve and enforce private agreements requiring purchasers in first sales to pay in excess of the Congressionally mandated maximum lawful prices for such sales. Rather, the Commission views its prosecutorial discretion in the nature of a negative right to withhold action, *i.e.*, a right to conserve its resources by not taking all the actions necessary in a particular case to provide a full remedy for a violation. In this respect, in *Heckler* the Court stated "When an agency refuses to act it generally does not exercise its *coercive* power over an individual's liberty or property rights, and thus does not infringe upon areas that courts often are called upon to protect."[18]

19. With this background, we now turn to an explanation why the circumstances surrounding the Omnibus Settlements justified the Commission's exercise of its prosecutorial discretion to not require every producer under those settlements to pay the entire amount of alleged excess payment. We then explain why those circumstances did not exist as to the Burlington settlements, and thus there was no basis to exercise prosecutorial discretion and to not seek to enforce the NGPA prohibition against a producer which admittedly received in excess of the MLP in first sales.

A. <u>The Omnibus Settlements</u>

20. In implementing *Public Service*, the Commission was faced with resolving hundreds, if not thousands, of *ad valorem* refund claims, involving events going back almost 20 years. To illustrate the extent of the magnitude of the problem, Colorado Interstate Gas Co. (GIG) sent refund statements to 570 working interest owners (WIO)s, and many challenged CIG's calculations or asserted an inability to pay. Eventually, the Commission approved a settlement which covered at least 430 WIOs.[19] Similarly,

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[17] 470 U.S. at 831-2.

[18] *Id.* at 832.

[19] 93 FERC ¶ 61,185 (2000).

Williams Gas Pipelines Central, Inc. sent statements to over 600 operators and WIOs. Producers filed over approximately 40 petitions for adjustment or sought other relief from their refund obligations. The Commission approved a settlement in 2000 which eliminated 636 of 652 claims,[20] and in April 2001 following continued settlement discussions the Commission approved a settlement of refunds not resolved by the earlier settlement.[21]

21. The same was true with respect to the two pipelines involved in these proceedings that sought the *ad valorem* refund from Burlington. Panhandle sought refunds from 836 operators and working interest owners. Many of the producers disputed the claimed refunds, and at least 45 petitions for adjustment or other relief were filed. Northern sought refunds from 790 producers, 738 of which were for less than $50,000. Similarly, many recipients of Northern's statements of refunds due protested the asserted claim, either in whole or in part. Producers objecting to Northern's claims filed 41 Petitions for adjustments or other relief. The objecting producers in both the Panhandle and Northern proceedings challenged, among other things, the claimed amount, the allocation of the amount among the working interest owners, and the collectability of the royalty owners' refund portion.

22. In an attempt to resolve the claims without the need for lengthy proceedings the Commission delayed acting in the many proceedings that had been commenced concerning the claimed refunds while settlement discussions were conducted among all affected parties, including the producer/first seller, the pipeline purchaser in the relevant first sale, the pipeline's customers who would benefit from any flow through by the pipeline of the refunds it received, and the state regulatory commissions in those jurisdictions where affected customer resided. The Commission's Dispute Resolution Service facilitated the settlement discussions.

23. The settlement discussions led to the filing of settlement offers pursuant to section 385.602 of the Commission's settlement rules. The settlements all followed the same basic outline of granting complete relief up to a stated amount, and above that amount the producer was obligated to pay the refund under the formula provided in the settlement. The settlements did provide for a reduction in the amount the pipeline claimed in the statement of refunds due but not necessarily a reduction in the amount of the admitted liability of the producer/first sellers since there were disputes as to the accuracy of the amount claimed by the pipelines. The "waiver" of a portion of the claimed liability

[20] 93 FERC ¶ 61,030 (2000).

[21] 95 FERC ¶ 61,055 (2001).

was consented to by pipeline purchaser in the relevant first sales as well as downstream entities with an interest in the flow through of the refunds. The settlements were voluntary, and were not binding upon any producer or affected downstream customer, or state regulatory commission which objected to the settlement. The settlements also provided that upon payment of that amount the producer "shall be released from any and all liability for refunds and any interest on refunds of Kansas *ad valorem* tax reimbursements owed to Panhandle and its customers under the NGPA for the subject period."[22]

24. The Panhandle settlement was filed by 37 producers and 14 non-producing parties.[23] The settlement was voluntary in that any of the 836 listed refund obligors could opt out of the settlement, as Burlington did. Parties who were entitled to receive a share of the *ad valorem* tax refund, and all state commissions that regulated such entities were considered settling parties unless they opted out of the settlement, as the Missouri Public Service Commission did. The Northern settlement followed the same pattern, and here too Burlington opted out of the settlement.[24]

25. Under section 385.602 (g)(3) of the Commission's settlement rule, the Commission may approve an uncontested settlement based on a finding that the settlement "appears to be fair and reasonable and in the public interest" without a determination on the merits of any litigated issue.[25] In approving the Omnibus Settlements, the Commission proceeded under section 385.602 (g)(3), and approved the Omnibus Settlements only for those who consented to them. The Commission approved each settlement in view of the strong public policy that supports settling complex matters that thereby avoids the costs and burdens of litigation and mitigates administrative burdens, as a reasonable compromise for those who chose to become parties to the settlement. As such the Commission found them "fair and reasonable and in the public interest." The order approving the Panhandle settlement specifically addressed Burlington's decision to "opt out" of the settlement, and stated that Burlington could continue to litigate its issues "albeit without recourse to any benefits of the Settlement."[26]

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[22] Section 12.4 of the Panhandle settlement approved by the Commission.

[23] 96 FERC ¶ 61,274 (2001).

[24] 93 FERC ¶ 61,311 (2000).

[25] *Trailblazer Pipeline Co.*, 85 FERC ¶61,345 at 62,339 (1998).

[26] 96 FERC at 62,043.

The Omnibus Settlements were two of the numerous settlements that resulted from the commission's enforcement efforts in implementing the Court's *Public Service* decision. All these settlements resulted in substantial payments to customers, while conserving Commission resources that could be devoted to other Commission actions. Absent the waiver provision of a portion of the refund total amount, the settlements could not have been achieved, and the Commission proceedings would likely have continued for many additional years, with uncertain outcomes.

26. Under these circumstances Commission approval of the Omnibus Settlements was an appropriate exercise of prosecutorial discretion pursuant to the standards discussed in *Heckler*. The Commission's action was consistent with the Commission's decisions in other situations to cease efforts to recover refunds when it has concluded that the expenditure of further Commission resources was unwarranted.[27]

27. The Commission's action in approving the Omnibus settlement reflected the Commission's prosecutorial discretion not to take additional enforcement actions against the producers who were parties to the settlements. Absent the settlements, the Commission would have had to expend substantial additional Commission resources to collect the refund from the multitude of producers, many of whom denied the amount of the claimed liability against them. The Commission determined that those Commission resources were better concentrated on current regulatory initiatives concerning today's natural gas and electric markets, rather than seeking to collect additional refunds for long past violations of statutory provisions no longer in effect.

28. Moreover, approval of the Omnibus Settlements did not constitute the exercise of coercive power over any party to the settlement, or even as to any non-consenting party. The Commission did not take any positive action to enforce any private agreement that violated the NGPA ceiling price, for example by requiring the pipeline purchaser to make additional payments to, or on behalf of, the producer seller in the relevant first sales. Rather, the Commission determined that once the producer parties to the settlements made the agreed-upon refunds, the Commission would allow the status quo to remain in effect with respect to those producers, and take no further action. This type of inactivity is particularly within the Commission's prosecutorial discretion. Thus, in *Baltimore Gas and Electric v. FERC, supra,* the court upheld the Commission decision to resolve an

[27] The Commission has taken such action as to *ad valorem* tax refunds, *Northern Natural Gas Co.,* 102 FERC ¶ 61, 015 (2003); NGA/ NGPA ceiling prices, *Stowers Oil & Gas Co.,* 71 FERC ¶ 61,383 (1995); NGPA Btu refunds, Refunds Resulting from Btu Measurement Adjustments; Proposed Commission Action, FERC Statutes & Regulations ¶ 35,020 (February 14, 1991).

enforcement action in a similar manner. There the Commission began an investigation of a pipeline's alleged service abandonment. Later after the Commission announced that it would not prosecute an enforcement action against the pipeline, but rather it would rely upon a settlement it had reached with the pipeline, a dissatisfied customer sought rehearing because the settlement did not provide for money damages. The Commission denied rehearing justifying its actions on its discretion not to order remedies for past violations in appropriate circumstances.

29. The Court affirmed the Commission's decision, finding it fell within the *Heckler* rationale since the Commission's decision to settle, "and its consequent decision not to see its enforcement action through to fruition, is a paradigmatic instance of an agency exercising its presumptively nonreviewable enforcement discretion."[28]

30. That as a result of the Omnibus Settlements some producers may end up retaining some amounts they collected in excess of the MLP, is not the equivalent of the Commission recognizing that NGPA section 504 "does not render unlawful all private agreement allowing a producer to retain funds collected" in excess of the MLP. As discussed above, and as the court held in *Southern Union*, *supra*, the Commission believes that all such agreements are unlawful and unenforceable. All that the Omnibus Settlements bring about is a termination of Commission enforcement actions with respect to the subject producer, so that while NGPA section 504 makes it illegal for a producer to receive more than the MLP, the amounts those producers may have received in violation of that section will be allowed to remain in those parties' possession, although the precise amounts a producer actually may have received in excess of the MLP was not established.

31. The Commission approved the settlements in the exercise of its prosecutorial discretion, as the Court stated, in light of "the strong public policy interests in support of settling complex matters in order to avoid the costs and burdens of litigation and to mitigate administrative burdens," particularly since:

> The Omnibus Settlement Agreements are 'a reasonable compromise to resolve long, drawn-out complex proceedings,' and that Commission approval will permit a substantial amount of the overcharges to be flowed through to consumers during the current heating season when gas prices are expected to be higher than in

[28] 252 F.3d at 460.

> recent years, while providing relief to Settling Parties, small producers, and royalty owners.[29]

32. Finally, the settlements do not include any "indemnity clause" comparable to the indemnity clauses in the Burlington settlements discussed below because the very purpose of the settlements is "to resolve all matters associated with the payment of Kansas *ad valorem* tax refunds"[30] on the pipeline's system.

B. The Burlington Settlements

33. The Commission now turns to the issue of whether the circumstances surrounding the Burlington settlements justify the Commission exercising a similar exercise of prosecutorial discretion as that it exercised in approving the Omnibus settlements. The Burlington settlements arose in a completely different context, and bear little similarity to the Omnibus Settlements except for the fact that they related to gas purchase contracts between Burlington and Panhandle and Northern.

1. The Panhandle 1992 Settlement

34. On November 24, 1992, Panhandle and Burlington entered into a two-page letter agreement to settle certain claims and controversies involving three different gas purchase agreements in three different states, one of which covered properties located in the State of Kansas (Kansas Contract). The letter agreement provided (a) for the decontrol of the gas under the Kansas Contract, effective July 1, 1992, (b) for Panhandle to pay an additional amount of $93,356.25 and taxes of $5,638.72 for gas previously purchased including some under the Kansas Contract, (c) for Panhandle to purchase a stated amount of natural gas for the period October 1, 1992 through December 31, 1992 at a stated price, and (d) for the termination of the contracts in Kansas and Texas effective January 1, 1993, and that the Wyoming contract terminated March 1, 1989.

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[29] 396 F.3d at 407-08.

[30] Page 2 of Explanatory Statement to Panhandle June 22, 2001 Stipulation and Agreement.

35. Paragraph 7 of the Letter Agreement stated:

> Except for the obligations and rights specifically provided in this Letter Agreement, Buyer and Seller hereby forever release, discharge, waive and indemnify each other from and against all claims, demands, causes of action, damages, liabilities, expenses or payments known or unknown, present or future, that each party has or may have had against the other party relating to all the above references contacts.

36. When Panhandle sent its statement of refunds due to Burlington, Burlington did not dispute the amount of the *ad valorem* tax reimbursement that Panhandle asserted was owing. Rather, it contended that Panhandle agreed to make any payments on behalf of Burlington as consideration for value received pursuant to the Letter Agreement, including the mutual release and indemnification and the termination of Panhandle's obligation to take additional volumes of gas under the contracts.

37. Burlington never quantified the alleged consideration, but merely asserted that Panhandle received consideration, and that "Burlington had already reimbursed Panhandle in the value of any *ad valorem* tax refund pursuant to the Letter Agreement."[31] When Burlington filed, pursuant to NGPA section 502 (c), a request in Docket No. SA99-1-000, for an adjustment from its refund obligation, Panhandle objected to the request. Panhandle stated "the primary consideration received by Panhandle under the Settlement was the premature termination of the gas purchase contracts. This has no connection to the volumes of gas that Panhandle had already taken under the subject contracts and for which the Kansas *ad valorem* tax reimbursements were made to Burlington."[32]

38. The Missouri Public Service Commission (MoPSC) similarly objected to the Burlington request in Docket No. SA99-1-000. MoPSC asserted that Burlington's contention that the 1992 settlement agreement releases it from the *ad valorem* liability

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[31] Response of Burlington May 12, 1999, in Docket No. SA 99-1-000 at 9.

[32] June 4, 1999, Response at 6.

was without merit. MoPSC stated "However, neither the parties nor the Commission suggested that the unliquidated Kansas *ad valorem* tax claims were consideration for the release cited by the petition."[33]

39. Panhandle reiterated its objection to Burlington's contention in its February 12, 2003 Answer to Burlington's request for rehearing in Docket No. RP98-40-031. Panhandle stated, at p. 11:

> In fact, the Letter Agreement relates solely to the *termination* of gas purchase contracts. The Letter Agreement does not change *anything* with respect to the historic sales here at issue. The agreement clearly specifies the rate changes required and the increased payments to be made by Panhandle to Southland for sales in 1992. The primary consideration received by Panhandle was the premature termination of the gas purchase contracts. The Letter Agreement has absolutely no connection to the volumes of gas that Panhandle had already taken under the subject contracts and for which unlawful Kansas *ad valorem* tax reimbursements were received by Burlington during the period of October 3, 1983 to June 28, 1988 (italics in original).

2. <u>The Northern-Burlington Settlement</u>

40. The Northern-Burlington settlement dated February 28, 1989, settled claims and controversies involving over 30 separate gas purchase contract covering properties in three different states, one of which was Kansas, and was entitled "Take-or-Pay Settlement Agreement." Among other things, the agreement provided for Northern to make a one-time non-recomparable payment for all take-or-pay claims under the contracts through June 31, 1989, and for Northern to make additional payment through April 30, 1992, set forth the price to be paid on the contract for the period February 1, 1989 through April 30, 1992, and to amend the gas purchase contract to reduce Northern's take obligation. The agreement also included in paragraph 5 the provision that each party agreed to release and indemnify the other party from all "liabilities, claims and causes of action -- arising out of, or in conjunction with, or relates to [the contract] for all periods through January 31, 1989…."

41. In response to Northern's statement of refunds due Burlington asserted that over $25,000,000 in take-or-pay liability was eliminated by the settlement through Northern's payment of $2,5000,000, and the Kansas contract accounted for $1,342,631 of this

[33] April 13, 1999, Protest at 4.

liability. Burlington contended that the settlement has already provided Northern with consideration far in excess of the *ad valorem* tax refunds at issue in this proceeding. While acknowledging that there was an *ad valorem* liability in the amount asserted against it, Burlington's position was that "Northern has assumed that responsibility in return for valuable consideration under the Settlement."[34]

42. Northern objected to Burlington's contention that the cited clause released Burlington of the *ad valorem* refund obligation. In Northern's answer to Burlington's request for rehearing, Northern stated that Burlington mischaracterized the 1989 Settlement when it claims that the settlement released Burlington from any refund obligation. Northern asserted that it did not agree in that settlement to allow Burlington to keep amounts in excess of the MLP or to release or indemnify Southland from its Kansas *ad valorem* tax refund liability for amounts received in excess of the MLP.[35]

3. Commission Ruling

43. While the Commission approved the Omnibus Settlements in the exercise of its prosecutorial discretion for the reasons stated above, these reasons do not exist with respect to the Burlington settlements. As a threshold matter, of importance is that the Burlington settlements are before the Commission in a different procedural posture than were the Omnibus settlements. As discussed above, the parties filed the Omnibus Settlements pursuant to the Commission's settlement rules in section 385.602, and the Commission approved those settlements for all consenting parties under section 385.602 (g) applicable to uncontested settlements,[36] which allowed the Commission to approve these settlements without resolving on the merits any litigated issues. By contrast the Burlington agreements were never submitted to the Commission for approval. To the extent Burlington seeks to equate its settlements to the Omnibus settlements Burlington fails to recognizes that both Panhandle and Northern dispute Burlington's interpretation of the "indemnity clause" in the respective agreements. Thus, while the Commission approved the Omnibus settlements as uncontested settlements, the Burlington settlements, at best, could be deemed contested settlements. As such the Commission must evaluate them on the merits.

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[34] Burlington Request for Rehearing at 15.

[35] February 6, 2005 Answer of Northern to Request for Rehearing at 5.

[36] *Trailblazer Pipeline Co.*, 85 FERC ¶61,345, at 62,339-42 (1998).

44. The Commission thus turns to the merits of whether, in this litigated case where there has been no uncontested settlement approved under section 385.602 (g) of our regulations, the Commission should require Burlington to refund the *ad valorem* tax reimbursements collected by it from Northern Natural and Panhandle, or whether the Commission should grant specific performance of the release and indemnity clauses and order the purchasing pipelines to be responsible for the refunds on behalf of Burlington. Burlington has conceded that the two pipelines, in their requests for refunds, correctly stated the amount of the *ad valorem* tax reimbursements they paid to Burlington during the 1983-1988 refund period which caused Burlington to receive more than the MLP for those sales, and in the amount of those reimbursements.

45. The primary basis asserted by Burlington for why the Commission should not require it to refund the amounts it unlawfully collected is the release and indemnity clauses in Burlington's 1989 and 1992 private settlement agreements with Northern and Panhandle respectively. Burlington interprets those clauses as allowing it to retain the *ad valorem* tax reimbursements it collected from Northern and Panhandle, but requiring Northern and Panhandle, the purchasers in the relevant first sale, to pay those same amounts to their customers. For purposes of this order, we accept Burlington's interpretation of the release and indemnity clauses.[37] However, for the reasons discussed below, we find that enforcing such a provision would go beyond any limited prosecutorial discretion Congress allowed the Commission when it enacted the NGPA first sale ceiling prices. The Commission also finds nothing in those clauses to justify a grant of adjustment relief pursuant NGPA section 502(c) in order "to prevent special hardship, inequity, or an unfair distribution of burdens." Thus, we reaffirm our previous orders that required Burlington to refund the amounts it concedes it collected in excess of the maximum lawful price to Northern and Panhandle.[38]

46. In *Southern Union*, the D.C. Circuit held that that the filed rate doctrine in *Arkla* applies not only to rates for services subject to the Commission's NGA jurisdiction, such as were at issue in *Arkla*, but also to the maximum lawful prices established by the NGPA. There a state court had ordered the purchaser in a first sale of natural gas to pay damages for negligent misrepresentation, despite the fact the payment of damages would cause the seller to receive more than the applicable NGPA maximum lawful price. The

[37] As noted above, both pipelines dispute this interpretation.

[38] Burlington has paid these refunds to the pipelines, which have flowed through the amounts to their customers.

Commission determined that the action of the state court was permissible. The D.C. Circuit, however, held that "the state measure of damages is based upon, and has the effect of awarding a price for interstate gas that, to the extent that price exceeds federal guidelines, the state court had no power to award. To that extent, the settlement agreement simply is a bargain that the state has no power to enforce."[39] The court accordingly reversed the Commission's order permitting the state to enforce the settlement.

47. The above precedent makes clear that any private agreement between the purchaser and seller in a first sale, including an agreement intended to settle disputes between the two parties, which requires the purchaser to pay in excess of the applicable maximum lawful price is illegal and unenforceable. The release and indemnity clauses, as interpreted by Burlington, constitute just such a private settlement agreement. Requiring Northern and Panhandle, the purchasers in Burlington's first sales, to make the refunds of *ad valorem* tax reimbursements that would otherwise be owed by Burlington, while Burlington is allowed to retain those amounts, is the equivalent of requiring the purchasers to pay the first seller in excess of the applicable maximum lawful price. The conclusion is unavoidable that the release and indemnity clauses are illegal and unenforceable.

48. Burlington suggests, in essence, that we use our prosecutorial discretion to enforce the release and indemnity clauses of its private settlement agreements with Northern and Panhandle. However, enforcing those clauses, as interpreted by Burlington, would go beyond any limited prosecutorial discretion Congress allowed the Commission in enacting the NGPA first sale ceiling prices. The Commission would not simply be withholding an enforcement action against Burlington and thereby permitting its violation of NGPA ceiling prices to go unremedied. Rather, the Commission would be taking a positive coercive action to enforce an illegal private settlement agreement and ordering the pipeline purchasers in the first sales to pay an amount in excess of the Congressionally mandated NGPA ceiling prices.

49. Thus, accepting Burlington's position would require the Commission to order the pipelines to pay the refunds, a clearly coercive act going beyond the prosecutorial discretion discussed in *Heckler*. While the Commission's refusal to require a 100 percent recovery in the Omnibus Settlements allowed the status quo to remain as to some portion of MLP violation, adopting Burlington's view would require the exercise of coercive power over the pipelines. Thus one of the core reasons for the recognition of administrative agency's prosecutorial discretion is not applicable to the Burlington

[39] 857 F.2d at 818.

settlement. The Commission is not aware of any instance in the history of its administration of the NGPA where it has ordered purchasers in a first sale to pay in excess of the NGPA maximum lawful price. In any event, such action would be directly contrary to the Supreme Court's holding in *Arkla* that the Commission lacks the authority to alter a lawful rate, since it would require the purchasers to pay in excess of the lawful rate for past purchases. It would also be contrary to *Southern Union*, since it would entail the Commission enforcing an illegal private settlement agreement.

50. Nor, as previously discussed, do any of the other reasons, set forth in *Heckler*, exist. In the prior section the Commission described the reasons why it exercised its prosecutorial discretion to approve the Omnibus Settlements. Through the Omnibus Settlements producers agreed to disgorge a substantial amount of the overcharges, which might not have been recovered as quickly, and in that amount absent the settlements, while conserving Commission resources that were now available for other Commission activities. The Burlington Settlements exhibit none of these reasons. The amount of the refund owing was never in dispute, so allowing the waiver of the liability would not conserve any Commission resources that would have been devoted in establishing the amount of Burlington's liability. Moreover, to allow the waiver of the amount Burlington admittedly owed could be expected to be contested by the two pipelines to the same extent Burlington has contested our order that it make the refunds.

51. As to Burlington's request for adjustment relief under NGPA section 502(c) the Court stated that the Commission denied Burlington's request for such relief as to interest because Burlington had not shown the required special hardship, or inequity. To satisfy this requirement the Commission has always required the petitioner to meet the "out-of-pocket" test in *Peter Cooper Corp.*, 15 FERC ¶ 61,027 (1981). Burlington has not sought relief on this basis. Rather it contends that since it has supplied consideration in such a large amount to the pipelines in the take-or-pay settlements involving the gas contracts that gave rise to the *ad valorem* refunds, it should not be required to also pay the *ad valorem* refunds related to those contracts.

52. Whether or not the *ad valorem* refunds were considered in the negotiations that resulted in the Burlington settlements, those refunds could not be eliminated in any take-or pay settlement. The purpose of the Commission's 1985 Take-or-Pay Policy Statement,[40] was to encourage producers and pipelines to settle the pipeline's take-or-pay obligations. The Commission addressed the concern that the settlement payments might be challenged as violating the NGPA because the recipient was receiving more than the MLP on its sales under the contracts relating to those payments. Thus the Policy

[40] FERC Stats. & Regs. Regulations Preambles 1982-1985 ¶ 30,637.

Statement was careful in explaining that such payments related to payments for not taking gas, and they had no application to payments for gas delivered during a particular month. *Id.* at 31,303. The Policy Statement never sanctioned any type of agreement as part of settling take-or-pay obligations that would require a purchaser in a first sale to pay more than the MLP on any gas it actually purchased, which is what Burlington advocates here. In fact in *Williams Natural Gas Co*., 67 FERC ¶ 61,153 at 61,450 (1994), the Commission stated "Thus take-or-pay… settlements between pipelines and their producer/suppliers cannot interfere with refunds required by the Commission to remedy violations of NGPA ceiling prices…" As a sophisticated participant in the natural gas industry, Burlington and its predecessor should have known that to the extent the release and indemnity clauses were intended to allow Burlington to retain amounts collected in excess of the MLP, there was, at the very least, a substantial risk that the provision would be considered illegal and unenforceable. This is particularly so, since the 1988 *Southern Union* decision, discussed above, was issued before either of the Burlington settlements were entered into.

53. Burlington's position is that as a matter of equity it should be relieved of its refund obligation because through the take-or-pay settlements the pipelines have received more consideration than the amount of the *ad valorem* refunds at issue here. However, the equitable relief Burlington seeks relies upon a clearly illegal agreement. We do not regard an unlawful agreement as an appropriate basis for equitable relief.

54. Moreover, Burlington mischaracterizes the nature of the consideration under the settlement by implying that the consideration it gave was in exchange for the *ad valorem* indemnification clause.[41] The take-or pay settlements were mutual exchanges of consideration to resolve the industry problems caused by the long-term gas purchase contracts between producers and pipelines. Thus, Burlington not only received the substantial immediate payment from the pipeline for actual and potential breaches of take-or-pay clauses in the contract, but Burlington obtained release of the gas from its dedication to the original contracting pipeline enabling Burlington to sell the gas to other buyers. In addition, Burlington now had rights to obtain open access transportation of that gas over the pipeline's system without the need to grant take-or-pay credits to the pipeline for any of its gas transported on that pipeline pursuant to section 284.8 (f) of the Commission's regulations, adopted in Order No. 500. In fact, as explained in Order

[41] As explained above in P 37, Burlington never made any claim that in the Panhandle-Burlington settlement it gave Panhandle consideration in excess of the amount of the *ad valorem* refund that Panhandle asserted was owing by Burlington.

No. 500-H,[42] payments by pipelines under the take-or-pay settlements were generally less than 20 percent of the total producer claims settled by those payments, so Burlington's settlement was typical of industry settlements.[43] Since all major pipelines entered into take-or-pay settlements, and those settlements would have a general release and indemnity clause similar to those in Burlington's settlements,[44] accepting Burlington's argument here would be applicable to every take-or pay settlement, and would, in effect, eliminate most *ad valorem* refund claims when it is clear that the Policy Statement concerning settlement of take-or-pay claims never intended to permit producers, by settlement, to obtain more than the NGPA maximum lawful prices for gas actually taken. Thus, the Policy Statement explicitly stated in allowing producers to receive the payments under the take-or-pay settlements the Commission was not sanctioning payments in excess of the NGPA ceiling prices because the settlement payments to resolve pipeline take-or-pay obligations were not for gas taken. Accordingly, we see no basis on which to grant equitable relief to Burlington.

The Commission orders:

The Commission reaffirms the prior orders that Burlington is responsible for payment of the *ad valorem* refund claims asserted against it by Panhandle and Northern.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.

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[42]FERC Statutes & Regulations, Regulations Preambles 1986-1990 ¶ 30,867 (1989), *aff'd American Gas Association v. FERC,* 912 F.2d 1496 (D.C. Cir. 1990).

[43] *See* Table 5 in Order No. 500-H.

[44] *See Southern Star Central Gas Pipeline Inc.*, 108 FERC ¶ 61,182 at 62,087 (2004) quoting Article XVI in a take-or-pay settlement. The clause states, in part, "Both parties herby forever release and discharge each other from any and all claims, demands, and causes of actions, arising out of or relating to [specified] Gas Purchase Contracts, or any other gas purchase contracts listed in the litigation…."