

120 FERC ¶ 61,170
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

El Paso Natural Gas Co. Docket No. RP00-336-032

Aera Energy, LLC, *et al.*,
Complainants Docket No. RP01-484-006

v.

El Paso Natural Gas Co.,
Respondents

Texas, New Mexico and Arizona Shippers,
Complainant Docket No. RP01-486-006

v.

El Paso Natural Gas Co.,
Respondent

KN Marketing, L.P.,
Complainant Docket No. RP00-139-008

v.

El Paso Natural Gas Co.,
Respondent

ORDER ON REHEARING

(Issued August 20, 2007)

1. On May 26, 2006, the Commission issued its Order on Remand¹ in this proceeding, which affirmed the Commission's prior decision that a reallocation of costs among El Paso Natural Gas Company's (El Paso) former full requirements shippers is not justified. Southwest Gas Corporation (Southwest) sought rehearing of the Commission's decision. As explained below, Southwest's request for rehearing is denied. The Commission finds that a reallocation of costs is not consistent with section 5 of the NGA or *Mobile-Sierra*,² and that the narrow remedy the Commission adopted is appropriate and does not alter the relationship between rates and services for the former full requirements (FR) shippers.

I. Background

2. A detailed discussion of the background of this proceeding is set forth in the May 26, 2006 Order³ and will not be repeated here. Briefly, in several prior orders in this proceeding,⁴ the Commission has taken action to resolve the capacity allocation problems that had rendered firm service on El Paso unreliable. Specifically, in an order dated May 31, 2002, the Commission, in an effort to restore reliable firm service on El Paso, directed El Paso to convert the contracts of its FR shippers to contract demand (CD) contracts with demand limits up to El Paso's available capacity so that service to one firm shipper would not adversely affect firm service to others.⁵ This action required

¹ *El Paso Natural Gas Co.*, 115 FERC ¶ 61,259 (2006).

² *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956); *United Gas Pipeline Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956).

³ *El Paso Natural Gas Co.*, 115 FERC ¶ 61,259 (2006) at P 3-14.

⁴ *El Paso Natural Gas Co.*, 99 FERC ¶ 61,244 (2002) (May 31, 2002 Order), 100 FERC ¶ 61,285 (2002) (September 20, 2002 Order), *order on reh'g*, 104 FERC ¶ 61,045 (2003) (July 9, 2003 Order), 104 FERC ¶ 61,044 (2003) (July 9, 2003 Compliance Order), *order on reh'g*, 106 FERC ¶ 61,233 (2004) (March 8, 2004 Order), *aff'd*, *Arizona Corporation Commission v. FERC*, 397 F.3d 952 (2005), 115 FERC ¶ 61,259 (2006) (May 26, 2006 Order).

⁵ Prior to the issuance of those orders, El Paso served its firm customers under two types of contracts, *i.e.*, FR and contract demand (CD) contracts. CD contracts provide delivery rights up to specified quantity limitations at delivery points specified in the contract. FR contracts, on the other hand, provided that El Paso must deliver and the customers must take the customer's full natural gas requirements each day. Thus, FR

(continued...)

the Commission to modify portions of El Paso's 1996 Settlement Agreement (1996 Settlement or Settlement)⁶ with its shippers. The Commission found that these modifications to the 1996 Settlement were consistent with the public interest standard of *Mobile-Sierra*.

3. When originally approved by the Commission, the 1996 Settlement provided a resolution to the difficult issue of unsubscribed capacity on El Paso's system through a package of provisions, including a risk sharing and revenue crediting mechanism, lower rates that would apply for a ten-year period in the form of a rate cap, subject to an annual inflation adjustment, and improved firm access to the San Juan Basin to reduce capacity constraints. The Settlement also resolved other difficult issues such as fuel usage, bypass, and functionalization. In approving the Settlement, the Commission stated that one of the benefits of the Settlement was that it provided long-term rate certainty and stability since the Settlement rates would apply for a ten-year period.⁷ The rates in the 1996 Settlement were uncontested "black box" rates, and thus the derivation of the rates is not set forth in the Settlement.⁸ Under the rate provisions of the Settlement, CD shippers paid stated demand charges for their contract demand amounts, while the FR shippers paid monthly charges based on their negotiated billing determinants, regardless of the amount of capacity they used during the month.⁹ The FR customers agreed to fixed annual revenue requirements from which monthly payments were derived. The billing determinants did not change throughout the 10-year term of the Settlement

customers were not limited to any specific contract demand quantity. Under El Paso's tariff, if El Paso had insufficient capacity to serve all transportation requests at a nominated receipt pool, firm shippers were subject to *pro rata* cuts in service based upon available capacity.

⁶ The Commission approved the 1996 Settlement in *El Paso Natural Gas Co.*, 79 FERC ¶ 61,028, *reh'g denied*, 80 FERC ¶ 61,084 (1997).

⁷ 79 FERC at 61,126.

⁸ *El Paso Natural Gas Co.*, 79 FERC ¶ 61,028 at 61,130, 61,131. *See also* Request for Rehearing of Southwest Gas, filed August 7, 2003, at p. 10.

⁹ May 31, 2002 Order, 99 FERC at 61,998.

regardless of the actual level of service taken by the FR customers. Therefore, the charges paid by the FR customers were constant, even as their demand changed and grew.¹⁰

4. In the May 31, 2002 Order, the Commission found that modification of the 1996 Settlement was in the public interest, but only to the extent necessary to restore reliable firm service on El Paso. The Commission determined that the remainder of the 1996 Settlement would stay in place. The conversion of FR service to CD service became effective on September 1, 2003. The court affirmed the Commission's decision in *Arizona Corporation Commission v. FERC*.¹¹ Specifically, the court affirmed the Commission's findings that unrestricted growth rights under FR contracts "posed an unusual threat to the public interest" and that, while there was no single cause to the capacity crisis, "any solution must tie future growth in FR customers' demands to appropriate allocation of costs related to those demands as well as to capacity expansions....[I]ncreases [in FR usage] take place without any added revenue responsibility and provide no incentive for El Paso to build additional facilities."¹²

II. Prior Commission Orders on the Reallocation of Costs

5. In the May 31, 2002 Order, the Commission attempted to minimize the changes to the 1996 Settlement while taking action to alleviate the service reliability problems on the system, and therefore, did not modify the Settlement rates. However, in an order dated September 20, 2002,¹³ the Commission directed El Paso to reallocate the aggregate FR revenue responsibility among the FR shippers *pro rata* based on the new CD levels. Arizona Public Service Company and Pinnacle West Energy Cogeneration (APS/Pinnacle) sought rehearing of the September 20, 2002 Order on this issue, and argued that there was no factual or legal basis for redistributing the revenue responsibility that was expressly negotiated, agreed to, and approved as part of the 1996 Settlement.

¹⁰ *Id.*

¹¹ *Arizona Corporation Commission v. FERC*, 397 F.3d 952 (D.C. Cir. 2005).

¹² *Id.* at 955 (*citing* the May 31, 2002 Order).

¹³ 100 FERC ¶ 61,285 at P 33 (2002).

6. In a July 9, 2003 Order on Rehearing,¹⁴ the Commission reconsidered and reversed the September 20, 2002 ruling on the cost reallocation issue, stating that it was not necessary to reallocate costs among the FR shippers to resolve the capacity allocation problems on the El Paso system. The Commission explained that its section 5 action in this proceeding was narrow and intended only to remedy the firm service interruptions on El Paso that had rendered firm service unreliable. The Commission determined that reallocation of costs would go beyond this narrow purpose and unnecessarily disturb the parties' settlement bargain.

7. Southwest sought rehearing of the cost reallocation portion of the July 9, 2003 Order.¹⁵ Southwest argued that the Commission's failure to reallocate revenue responsibilities placed Southwest at a competitive disadvantage by changing the relationship between service entitlements and revenue responsibility. Southwest stated that its effective "unit rate"¹⁶ for firm service to Arizona is \$5.4983 per dth, while the same firm service to Arizona is \$2.3287 per dth for APS and \$1.1575 per dth for Salt River Project Agricultural Improvement and Power District (Salt River Project).

8. In a March 8, 2004 Order on Rehearing,¹⁷ the Commission denied Southwest's request for rehearing. The Commission explained that the difference in unit rates among

¹⁴ 104 FERC ¶ 61,045 (2003).

¹⁵ BHP Copper also filed a request for rehearing on this issue. Public Service Company of New Mexico and El Paso Electric Company filed comments in Docket No. RP00-336-005, *et al.*, objecting to revenue reallocations. Other former FR shippers on El Paso who did not object to the Commission's decision to maintain the Settlement rates, and who will be impacted by the Commission's decision in this order, include Arizona Electric Power Cooperative, Inc.; Arizona Gas Division of Citizens Communications Company; ASARCO Inc.; El Paso Municipal Customer Group; Navajo Tribal Utility; Phelps Dodge Corporation; Salt River Project Agricultural Improvement and Power District; and Southern Union Gas Company.

¹⁶ Neither the 1996 Settlement nor the Commission's orders in this proceeding establishes "unit rates" for any shipper. Southwest has calculated a unit rate using the Settlement billing determinants and the amount of capacity allocated to the former FR shippers. *See* the May 26, 2006 Order on Remand, *El Paso Natural Gas Co.*, 115 FERC ¶ 61,259 at P32-36.

¹⁷ *El Paso Natural Gas Co.*, 106 FERC ¶ 61,233 (2004).

the FR customers about which Southwest complained did not result from the conversion of FR service to CD service, but stemmed from the level of FR service provided by El Paso pursuant to the 1996 Settlement. The Commission further explained that at the time of the Settlement, each FR shipper was assigned an agreed-to revenue responsibility, but was not limited to any specific demand or volume level in connection with that revenue responsibility. Thus, the Commission stated that the Settlement permitted changes in the FR shippers' use of the El Paso system with no change in revenue responsibility.

9. Southwest sought judicial review of the Commission's decision not to reallocate costs among the former FR shippers. The Commission requested that the court remand its decision to provide the Commission with an opportunity to further consider its ruling on the cost reallocation issue.

10. In an order issued May 26, 2006, the Commission gave additional consideration to Southwest's concerns. However, upon further consideration, the Commission again concluded that there is no basis for modifying the Settlement rates during the remaining term of the Settlement. The Commission explained that under the remedy it adopted in this proceeding, each former FR shipper received an allocation of available system capacity equal to its proportional use of the system under the Settlement, at the Settlement rate to which it had agreed and which it had been paying. Thus, the Commission stated, its remedy did not change the rates paid by the former FR shippers, but simply maintained the *status quo* on the system for the remainder of Settlement period.

11. The Commission addressed Southwest's assertion that the Commission's orders failed to comply with section 5 of the NGA because the Commission did not establish just and reasonable rates on El Paso. The Commission explained that although its determination under section 5 of the NGA that El Paso's capacity allocation methodology was contrary to the public interest required the establishment of an allocation methodology that was in the public interest, this determination did not require the establishment of new rates on El Paso. The Commission also explained that any proposed modification to the Settlement rates must be evaluated under the public interest standard of *Mobile-Sierra*, and that the *Mobile-Sierra* public interest standard is higher and more difficult to meet than the statutory unjust and unreasonable standard. The Commission further explained that while extraordinary circumstances had required the conversion of FR contracts to CD contracts in the public interest, Southwest had shown no harm to the public interest from continuing the Settlement rates for the term of the Settlement.

III. Discussion

12. On rehearing of the May 26, 2006 Order, Southwest repeats, almost verbatim, the arguments and characterizations that it made in its earlier pleadings and that the Commission specifically rejected in the May 26, 2006 Order. In large part, Southwest's request for rehearing does not address the discussion and rationale of the May 26, 2006 Order. As discussed below, we find that Southwest failed to raise any arguments not already addressed by the Commission and has not presented any basis for rehearing.

A. The Narrow Scope of the Commission's Remedy is Appropriate

13. In explaining its decision not to modify the 1996 Settlement rates, the Commission stated in the July 9, 2003 Order that its section 5 action in this proceeding was narrow and intended only to remedy the service interruptions that rendered firm service on El Paso unreliable. The May 26, 2006 Order affirmed this position, stating that modifying the Settlement only to the extent necessary to resolve the capacity allocation crisis on El Paso is consistent with the Commission's policy favoring settlements, as well as with the requirements of *Mobile-Sierra*.

14. On rehearing, Southwest again argues that there is no "narrow purpose" exception in section 5 of the NGA, and even if there were such an exception, the Commission failed to explain why it requires the Commission to correct the capacity allocation problem and not reallocate revenue responsibilities. Contrary to Southwest's contention, the May 26, 2006 Order does not stand for the proposition that there is a "narrow purpose" exception to section 5 of the NGA. In the July 9, 2003 Order, the Commission stated its section 5 action in this proceeding was narrow and intended only to remedy the service interruptions that rendered firm service on El Paso unjust and unreasonable. The Commission further concluded that reallocation of costs among the FR shippers would go beyond that narrow purpose and would unnecessarily disturb the parties' settlement bargain. In the May 26, 2006 Order, the Commission provided additional support for this position by explaining that disturbing the Settlement only to the extent necessary to resolve the capacity allocation crisis and restore reliable firm service on the El Paso system is consistent with the Commission's policy favoring settlements, as well as with the requirements of *Mobile-Sierra*. Nowhere did the Commission imply or state that its actions were justified under a "narrow purpose" exception to section 5 of the NGA.

15. In stating that its section 5 action was narrow, the Commission meant only that in an effort to give due consideration to the policy favoring settlements and the requirements of *Mobile-Sierra*, the Commission modified only the sections of the Settlement necessary to restore reliable firm service on El Paso. The Commission's action was consistent with *Mobile-Sierra* because it was in the public interest to change El Paso's capacity allocation, while there was no showing that the public interest required

a change to any other portion of the Settlement. By modifying the Settlement only to the extent necessary to restore reliable firm service on El Paso, the Commission appropriately balanced the interests and preserved the bargains of the parties. Contrary to Southwest's assertion, the Commission did not rely on any so-called "narrow purpose" exception to section 5 of the NGA.

16. Southwest also contends the Commission acted inconsistently with its stated "narrow purpose" of restoring reliable firm service on El Paso's system because the Commission also changed customers' capacity release rights under the Settlement. Southwest states that the Commission did not provide a *Mobile-Sierra* rationale for this change, and that the changes to the capacity release rights appear to be merely a "conforming change" designed to bring the capacity release rights of El Paso's new CD customers in line with the rights of El Paso's original CD customers and CD customers of other pipelines. Southwest asserts that, like the change to the former FR shipper's capacity release rights, reallocating revenue responsibility is simply another "conforming change" that the Commission should require without considering the *Mobile-Sierra* requirements.

17. We find that Southwest's analogy of a proposed reallocation of costs among former FR shippers to changes in capacity release rights is not apt. In the May 26, 2006 Order, the Commission explained that after the conversion of FR contracts to CD contracts, shippers may release capacity up to their new CD levels, whereas prior to the conversion shippers could release capacity up to their billing determinants. The limitation on the volumes that could be released by the FR shippers to their billing determinants was imposed in El Paso's restructuring proceeding under Order No. 636, where the Commission held that limiting the amount of capacity that the FR shippers could release to their billing determinant level was appropriate because otherwise these shippers would have no limits on the amount of capacity they could release since there was no contractual limit to the amount of capacity they could demand.¹⁸ The Commission further addressed the problem of FR service and capacity release in a later order in El Paso's restructuring proceeding, and clarified that when a FR shipper participates in the capacity release program, it loses its status as a FR customer.¹⁹

¹⁸ *El Paso Natural Gas Co.*, 61 FERC ¶ 61,333 at 62,287 (1992); 62 FERC ¶ 61,311 at 62,992 (1993).

¹⁹ *El Paso Natural Gas Co.*, 65 FERC ¶ 61,134 at 61,677 (1993), *order on reh'g*, 66 FERC ¶ 61,183 at 61,380 (1994).

Instead, the Commission stated, the FR shipper becomes a customer with a contract demand equal to its billing determinant level, less the capacity that it has released.²⁰

18. Thus, the restrictions on capacity release for FR shippers pre-dated the 1996 Settlement and grew out of the inherent incompatibility of FR service and capacity release. The elimination of FR service on El Paso renders these limitations unnecessary, and the Commission's capacity release regulations can now apply to all shippers on El Paso's system. No party has objected to the application of the Commission's capacity release regulations to former FR shippers and Southwest specifically states that it does not object to this change.²¹

19. In contrast to the removal of the capacity release restrictions that applied to former FR shippers due to the nature of FR service, the fixed revenue responsibility for a 10-year period was a significant part of the parties' bargain contained in the 1996 Settlement. In approving the Settlement, the Commission stated that one of the benefits of the Settlement was that it provided long-term rate certainty and stability.²² The Offer of Settlement and Request for Approval of Stipulation and Agreement accompanying the 1996 Settlement also states that one of the benefits of the Settlement is long term rate certainty and stability.

20. Thus, the cost allocation provisions of the Settlement were a significant part of the 1996 Settlement bargain, while the restrictions on capacity release pre-dated the 1996 Settlement and were a result of the inherent incompatibility of capacity release with full requirements service. No party has objected to the elimination of the restrictions on capacity release for the former FR shippers, while some former FR shippers (unlike Southwest) still value their Settlement rate bargain and oppose a reallocation of costs.²³

²⁰ *Id.*

²¹ Southwest's Request for Rehearing at 6.

²² 79 FERC ¶ 61,028 at 61,126 (1997).

²³ See Joint Request for Rehearing of the Commission's September 20, 2002 Order of APS/Pinnacle (October 21, 2002). See also Comments of Public Service Company of New Mexico on El Paso Natural Gas Company's December 2, 2002 Capacity Allocation Report (January 13, 2003) and El Paso Electric Company's Comments on Cost Allocation Proposals in December 3, 2002 Capacity Allocation Report (February 4, 2003). As explained in the May 26, 2006 Order, while a reallocation of costs as requested by Southwest would lower Southwest's rates, the rates of other FR shippers would increase.

Contrary to Southwest's contention, there is no similarity between the removal of capacity release restrictions for converted FR shippers that supports Southwest's request for a complete cost reallocation for every former FR shipper on El Paso. To the extent that Southwest is suggesting that the Commission could or should modify the 1996 Settlement to reallocate costs among the former FR shippers, and thus change each shipper's rate for the remainder of the Settlement period, without a finding under *Mobile-Sierra* that this cost reallocation is in the public interest, we find otherwise. All prior revisions made by the Commission to this Settlement have been subject to the *Mobile-Sierra* public interest standard of review.²⁴ Therefore, it follows that modifying the Settlement rates in the instant proceeding must also meet the public interest standard.

B. The Commission's Remedy is Consistent with Section 5 of the NGA

21. In the May 26, 2006 Order, the Commission explained that its actions in this proceeding complied with the requirements in section 5 of the NGA, as well as with *Mobile-Sierra*. The Commission stated that it examined the capacity allocation practices on El Paso's system, found that the allocation methodology was contrary to the public interest, and replaced the methodology with one that was in the public interest. The Commission found that this action did not require it to abrogate any other part of the Settlement, or to establish new rates on El Paso for the remainder of the Settlement period. Further, the Commission explained that the maintenance of the Settlement rates preserved the relationship between rates and services for the remaining two years of the Settlement term and appropriately balanced the interests of all of the parties.

22. On rehearing, Southwest argues that the Commission's remedy in the May 26, 2006 Order is insufficient under section 5 of the NGA. Southwest argues that once the Commission finds that a practice or rate is no longer just and reasonable, section 5 of the NGA requires the Commission to "determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force." Southwest contends that the Commission has not established just and reasonable rates on El Paso and has not expressly stated that the Settlement rates are just and reasonable. Southwest argues that the Settlement rates are unjust, unreasonable, and unduly discriminatory. Southwest also contends the Commission's determination that its remedies are consistent with section 5 of the NGA is premised on the incorrect conclusion that the substitution of FR service for CD service does not require the Commission to abrogate any other part of the Settlement. Southwest argues that the reasonableness of the Settlement rates cannot be determined in a vacuum. Southwest

²⁴ See May 31, 2002 Order, 99 FERC at 62,004-006; July 9, 2003 Order at P 42-45.

asserts that parties to the Settlement originally agreed to the billing determinants in light of their right to FR service, and once the Commission eliminated the FR service, it eliminated the basis for the Settlement. Southwest states that the agreement left in place by the Commission bears no resemblance to the 1996 Settlement and results in rates that are unjust, unreasonable, unduly discriminatory, and contrary to the intent of the Settlement.

23. The Commission has never found any of the various 1996 Settlement rates to be unjust and unreasonable. The Commission has found only that the continuation of FR service was contrary to the public interest and, therefore, replaced that service with CD service. The Commission has made no such finding with respect to the Settlement rates. In the absence of a showing that satisfied the applicable public interest standard of *Mobile-Sierra*, the Commission appropriately did not determine a new cost allocation to establish new rates for former FR customers on El Paso. To successfully challenge the decision on rehearing and persuade the Commission to prescribe different rates for all of the former FR shippers, Southwest would have to show that the Settlement rates were no longer in the public interest. Southwest has not made that showing.

24. Moreover, as the Commission explained in its May 26, 2006 Order, Southwest's argument that the Commission must review the 1996 Settlement rates under the just and reasonable standard of the NGA ignores the distinction between rates established under the just and reasonable standard and those established pursuant to uncontested settlements. The rates at issue here were agreed to pursuant to an uncontested settlement. The Commission's role in approving uncontested settlements is limited to ensuring that the settlement is fair, reasonable and in the public interest. The Commission approved the 1996 Settlement as fair and reasonable and in the public interest when it originally accepted the Settlement. The Commission has not changed the rates in that Settlement. As stated above, Southwest has not made the showing required to warrant a change in those rates.

25. Southwest's suggestion that the Commission's decision to eliminate FR service eliminated the basis for the Settlement, and therefore the Commission should abrogate the entire Settlement was specifically rejected by the Commission in the July 9, 2003 Order on Rehearing upheld by the court.²⁵ We will not revisit that issue here.

²⁵ 104 FERC ¶ 61,045 at P 93 (2003).

C. The Commission's Remedy is Consistent with *Mobile-Sierra*

26. In the May 26, 2006 Order, the Commission determined that in this instance reallocating Settlement rates would not be consistent with *Mobile-Sierra*. The Commission found that its determination that El Paso's capacity allocation methodology was no longer in the public interest did not in and of itself also require a reallocation of Settlement rates under *Mobile-Sierra*. The Commission concluded that before prescribing different rates for all of the FR shippers who were parties to the Settlement, it must find an independent basis to conclude that the Settlement rates were no longer in the public interest under *Mobile-Sierra*. In considering this issue, the Commission determined that Southwest had not shown any harm to the public interest from continuing the Settlement rates for the term of the Settlement. The Commission explained that Southwest merely argued that it had been disadvantaged with respect to other FR shippers, and this was not a sufficient basis for disturbing the rate certainty that was a significant part of the Settlement bargain for all parties.

27. On rehearing, Southwest argues that *Mobile-Sierra*'s public interest standard does not eliminate the Commission's responsibility to ensure that rates are just and reasonable under section 5 of the NGA, and that the *Mobile-Sierra* public interest standard and the NGA section 5 just and reasonable standard are consistent with one another. Southwest argues that unjust, unreasonable, and unduly discriminatory rates are, by definition, contrary to the public interest.

28. In addition, Southwest argues that ensuring that shippers pay for the service they receive, as required by *Dominion Cove Point*,²⁶ is consistent with *Mobile-Sierra* and should not be sacrificed for reliable service on El Paso. Southwest claims that pursuant to the rates upheld in the May 26, 2006 Order, Southwest is paying too much for service in comparison to other shippers, making the rates unjust and unreasonable, and therefore, against the public interest.

29. Contrary to Southwest's assertion, the public interest standard required by *Mobile-Sierra*, is not the same as the NGA just and reasonable standard. Southwest seemed to understand this distinction when it filed its comments on El Paso's capacity allocation proposal.²⁷ As Southwest stated in its comments, the public interest standard under

²⁶ *Dominion Cove Point LNG, LP*, 115 FERC ¶ 61,337 at P106 (2006) (*Dominion Cove Point*).

²⁷ See Comments of Southwest Gas Corporation on El Paso's March 28, 2001 Capacity Allocation Proposal, filed May 17, 2001 at p.2.

Mobile-Sierra is higher and more difficult to meet than the statutory unjust and unreasonable standard.²⁸

30. The Commission decided to convert FR service to CD service under *Mobile-Sierra* in light of the extraordinary circumstances that existed on the El Paso system during that time. Almost every shipper on the El Paso system, both FR and CD, was experiencing frequent cuts in firm service, rendering El Paso's firm service unreliable. The public interest required the Commission to take steps necessary to restore reliable firm service on El Paso, including converting FR service to CD service. In contrast, the public interest did not require the Commission to modify the Settlement rates. Such a change was not necessary to restore firm service on El Paso. In addition, the Commission found there was no direct link between reallocating the capacity of former FR shippers and changing Settlement rates. Instead the Commission determined that for the remainder of the Settlement term, the former FR customers should continue paying the same annual revenue requirement they were paying for the same amount of capacity they were taking. The Commission never suggested that Southwest or any other former FR customers pay the higher existing CD rate. It simply maintained the same annual revenue requirement the parties had originally agreed to for the capacity they were currently using. There was no reduction in service, only a limit on future growth in service.

31. As the Commission explained in the May 26 Order, the remedy adopted by the Commission essentially took a "snapshot" of the operation of the El Paso system under the Settlement in the 12-month period prior to the conversion of the FR contracts, and then locked into place that usage pattern as each former FR shipper's contract demand. Each FR shipper received an allocation of available system capacity equal to its proportional use of the system under the Settlement, with no change to the annual revenue requirement to which it originally agreed and which it had been paying. That Settlement rate (*i.e.*, the annual revenue requirement) was not based on the amount of capacity a FR shipper would use. Rather, as explained above, the Settlement rates were uncontested "black box" rates. The Commission's remedy simply maintained the status quo on the system for the remainder of the Settlement period. The reason the Commission maintained the annual revenue requirement but capped the contract demand for each FR shipper was because there was not enough available capacity on the El Paso system to allow continued growth in demand under the FR contracts. The Commission's

²⁸ *Id.*

remedy maintained the Settlement bargain that each FR shipper would pay a fixed annual revenue requirement over the 10-year term of the Settlement but did not allow continued growth.

32. As further explained in the May 26, 2006 Order, the difference in effective “unit rates” calculated by Southwest results from the operation of the Settlement, not from the Commission’s decision to convert the FR contracts to CD contracts. Under the 1996 Settlement, there was no provision or intent that the initial relationship between the revenue responsibility and system usage would be maintained throughout the term of the Settlement. On the effective date of the Settlement, each FR shipper’s “effective unit rate” was different from the “effective unit rate” that it paid at other times during the course of the Settlement as its demand increased or decreased, and was different from the “effective unit rates” paid by other FR and CD shippers. The Settlement did not contemplate that the agreed-to revenue responsibility of any shipper would be modified during the term of the Settlement to maintain any particular “unit rate” for that shipper. Southwest, like all parties to the Settlement, knew when it entered into the Settlement that its service demands could increase or decrease, and that its service demands relative to those of its competitors could change over the 10-year Settlement period without a change in its revenue responsibility or the revenue responsibility of its competitors.²⁹ The Commission’s remedy did not change this bargain.

33. The Commission’s approach was appropriate. While the reallocation of revenue responsibility advocated by Southwest would result in a decrease in Southwest’s revenue payments, the annual revenue payments of some of the other former FR shippers would increase above the level they agreed to in the Settlement, thereby eliminating the rate certainty that was a primary benefit of the Settlement. In essence, reallocating costs among the former FR shippers would have resulted in some shippers paying more and some paying less, and not in lower rates for all of the former FR shippers. The Commission determined that this outcome was not required by the public interest, and did not appropriately balance the interests of the parties.

34. Southwest was not disadvantaged by the Commission’s choice of a remedy in this case. Southwest has failed to demonstrate any harm to the public interest from maintaining the Settlement rates for the remaining two years of the term of the Settlement. Southwest has merely alleged that it perceives itself to have been disadvantaged with respect to other FR shippers. This is not a sufficient basis for disturbing the rate certainty, the flexible delivery, and the pooling of supplies that were

²⁹ May 26, 2006 Order at P 34-39.

significant parts of the Settlement bargain for all of the FR shippers. Further, as the Commission explained in the May 26, 2006 Order, a reclassification and reallocation of costs so that all customers, both CD and former FR, paid the same CD rate, is not appropriate here.³⁰

35. Southwest, like all other FR shippers, is paying the same annual revenue requirement after the modification of the 1996 Settlement as it did before, and is receiving the same proportionate share of capacity as it was before the conversion of the FR contracts. Because the 1996 Settlement locked in place the revenue requirements for FR shippers, but not the level of service for FR shippers, some FR shippers' loads have grown at a higher rate than others. Southwest is requesting that the Commission reallocate each FR shipper's annual revenue requirement so that each shipper pays the same per unit rate. This would result in a decrease in the annual revenue requirements of those shippers who now represent a smaller share of the total FR load (such as Southwest) and an increase to those other FR shippers who experienced a higher growth rate and now represent a larger share of the total FR load. As the rates established in the 1996 Settlement were not based on the amount of capacity used by FR shippers, Southwest has not shown that such a change is necessary or in the public interest.

36. Southwest also argues that under the Settlement, it retains the right to complain of unduly discriminatory rates under section 5 of the NGA. Southwest refers to section 16.6 of the 1996 Settlement which provides:

Waiver of section 5 Rights. In consideration for the provisions of this Stipulation and Agreement, the parties to the instant proceeding waive any right they might otherwise have during the term of this Stipulation and Agreement to challenge the level of the settlement rates provided for herein or any other provision of this Stipulation and Agreement as being unjust, unreasonable, or unduly discriminatory within the meaning of section 5 of the NGA; provided however, that such waiver does not preclude the filing of a complaint (i) based on a claim that El Paso has engaged in unduly discriminatory conduct with respect to rates established or services provided after the effective date of this Stipulation and Agreement, including the terms and conditions of such service *except to the extent such terms and conditions were expressly agreed to herein*; (ii) concerning the General Terms and Conditions of El Paso's Volume No. 1-A Tariff except

³⁰ 115 FERC ¶ 61,259 at P 49-50.

to the extent such terms and conditions were expressly agreed to herein; or (iii) as otherwise expressly provided in this Stipulation and Agreement. (Emphasis added).

37. This provision provides for the waiver of section 5 rights by the parties to the Settlement, except for a claim that El Paso has engaged in discriminatory conduct. This exception, however, does not apply to terms and conditions of service that were expressly agreed to as part of a Settlement. Since the Settlement rates were expressly agreed to in a Settlement, Southwest's right to challenge the rates in a complaint proceeding has been waived by the express terms of the Settlement. Therefore, section 16.6 of the Settlement does not support Southwest's claim.

D. The Commission's Remedy is Consistent with the its Policy Favoring Settlements

38. As explained previously, the Commission stated in its May 26, 2006 Order that its decision to preserve the Settlement rates and not reallocate costs is consistent with the Commission's policy favoring settlements. Preserving the bargains of the parties to the greatest extent possible encourages settlements and parties would be hesitant to resolve their disputes by settlement if the Commission did not honor these agreements to the greatest extent possible. The Commission's remedy here preserved the bargain in the 1996 Settlement to the maximum extent possible, consistent with the public interest.

39. On rehearing, Southwest contends the Commission's preservation of a rate that shippers agreed to in light of their right to FR service – a service the Commission subsequently eliminated – does not retain the bargains of the parties. In addition, Southwest explains that because FR service cannot be quantified, the billing determinants in the 1996 Settlement were only a tool for allocating cost responsibility and did not reflect shippers' monthly usage or demand rights.

40. Southwest also argues that the Commission places too much emphasis on the importance of maintaining the rate certainty established in the 1996 Settlement. Southwest asserts that simply because the Settlement created rate certainty does not mean the parties agreed to maintain the same revenue responsibility despite the elimination of FR service. Southwest also contends that there are not any provisions in the 1996 Settlement suggesting that rate certainty had any value to the parties absent FR service, or that rate certainty was intended to override FR customers' right to pay just and reasonable rates.

41. Southwest also argues that the rate component of the Settlement is not divisible from the rest of the agreement. Southwest contends that in all commercial transactions, payment and service, or in this instance, revenue responsibility and service rights, are

inextricably intertwined. Once the Commission eliminated FR service, Southwest argues that the fundamental basis for the shippers' bargain was gone. Southwest asserts that by maintaining the revenue allocation component despite the change in the service component, the Commission is not preserving the bargains of the parties. Rather, Southwest contends that the Commission is defining the former FR shippers' new CD rights on the El Paso system, but ignoring those rights when called upon to establish just and reasonable rates.

42. As the May 26, 2006 Order explained, the Commission is reluctant to modify a settlement while it is in effect, but extraordinary circumstances on El Paso's system required some modification. Consistent with its policy favoring settlements, the Commission attempted to minimize the changes to the Settlement while taking action to alleviate the service reliability problems on the system, and therefore, it did not modify the Settlement rates. By maintaining the rate certainty and terms and conditions of service that the parties established in the Settlement and have since relied upon, the Commission intended to preserve the bargains of the parties to the maximum extent possible. In doing so, the Commission recognized that the Settlement was a complex agreement consisting of many parts, such as the risk and revenue sharing provisions and fuel rate, flexible receipt and delivery points, functionalization and bypass provisions. The Commission noted that settling parties had agreed to, and relied upon, these provisions, and that restoring reliable firm service on El Paso did not require disturbing the entirety of the parties' bargain. Therefore, the Commission appropriately decided not to change the Settlement's rate structure simply because Southwest argued that it no longer benefited as much from the bargain to which it originally agreed.

43. Rate stability was an important component of the 1996 Settlement and should be preserved. In the May 26, 2006 Order, the Commission stated that it was neither fair nor consistent with the Commission's policy favoring settlements to require any of the former FR shippers to trade their bargain of rate certainty for higher rates. The Commission pointed out that FR shippers who were part of the Settlement agreed to a specific level of revenue responsibility that would not change for the 10-year term of the Settlement, and since then, many have relied upon this rate certainty. The Commission appropriately determined that retaining the Settlement rates for the remainder of the Settlement period appropriately balanced the interests of all of the parties to the Settlement.

44. The May 26, 2006 Order also fully explained why the Commission rejected Southwest's argument that the Settlement is a non-severable package deal. The Commission recognized that the 1996 Settlement was a package involving compromises on a number of issues, and that the parties might not have agreed to the Settlement in 1996 if all elements were not present. However, it does not follow that the Commission cannot, some six years later when the circumstances that prompted the Settlement had changed, exercise its authority as it did to change one portion of the Settlement that had

become contrary to the public interest. The Commission appropriately determined that the fact that the Settlement was entered into as a package, does not necessarily mean that if one portion of the Settlement is altered under *Mobile-Sierra*, other portions must also be changed. Therefore, the Commission's decision to modify the Settlement only to the extent necessary to restore reliable firm service on El Paso was consistent with the Commission's policy favoring settlements, and with section 5 of the NGA and the *Mobile-Sierra* doctrine.

E. The Commission's Remedy Does Not Alter the Relationship Between Rates and Services Established in the 1996 Settlement

45. In the May 26, 2006 Order, the Commission explained that the remedy it adopted essentially took a "snapshot" of the operation of the El Paso system under the Settlement in the period prior to the conversion of the FR contracts, and then preserved that usage pattern as each former FR shipper's contract demand. The Commission stated that each FR shipper received an allocation of available system capacity equal to its proportional use of the system under the Settlement, at the Settlement rate to which it had agreed and which it had been paying. Therefore, the Commission stated that instead of changing the relationship between service and rates, as Southwest alleges, the remedy adopted by the Commission simply maintained the status quo on the system and preserved the relationship between rates and service that existed at the time of the conversion for the remainder of the Settlement.

46. Southwest disagrees with the Commission's finding that it did not change the relationship between rates and services, and that the decision appropriately balances the interests of all the parties to the Settlement. Southwest contends that the Commission's assertions are based on the false premise that the relationship between rates and services should be based on the amount of gas the former FR customers took from El Paso in the 12-month period prior to the elimination of FR service. Southwest argues that the Commission should not have considered the amount of service taken by the shippers prior to the discontinuation of FR service because it is a matter outside of the Settlement and because doing so is contrary to the fundamental nature of CD service under a straight fixed variable (SFV) rate design. Southwest explains that CD customers pay demand charges for the right to demand service, and not in exchange for the gas they receive. However, what the Commission locked into place according to Southwest, were rates based on a 12-month snapshot of shippers' former FR usage, and not the pre-existing right to demand service. Southwest also argues that despite the Commission's acknowledgement the 1996 Settlement conveyed no intent to maintain the initial relationship between revenue responsibility and system usage throughout the term of the Settlement, the effect of the Commission's orders is to preserve such a relationship.

47. We disagree. In this proceeding, the Commission had an obligation to adopt a remedy to address the collapse of service reliability on El Paso. The remedy adopted by the Commission was to convert FR contracts to CD contracts with new CDs based on the former FR customers' use of the system. This remedy has been upheld by the court and is therefore final and non-appealable and not at issue here. Therefore, we shall not address Southwest's criticism that the Commission should not have considered usage patterns in adopting its remedy to the capacity allocation crisis on El Paso. The only matter at issue here is whether the adoption of that remedy requires a reallocation of costs. As discussed in detail above, the Commission has determined that it did not.

48. In addition, as the Commission explained in prior orders, it did not alter the relationship established in the 1996 Settlement between rates and services. In the May 26, 2006 Order, the Commission emphasized that it did not "establish" the Settlement rates or "assign" Southwest a billing determinant; the revenue requirements and billing determinants in the 1996 Settlement were agreed to by Southwest and all of the parties to the Settlement. The amount of capacity allocated to each former FR customer in the May 31, 2002 Order was based on the amount of system capacity the customer was taking under the Settlement pursuant to its FR contract. Thus, each former FR customer's new CD was its proportional share of the available capacity on the El Paso system, as determined by each customer's use of the system in the year prior to the conversion of the contracts. The revenue requirements were locked in place for the term of the Settlement and did not change with any change in usage. Therefore, the Commission properly concluded that instead of changing the relationship between service and rates on El Paso, the Commission's action in this proceeding preserved the relationship between service and rates that existed on El Paso under the Settlement at the time of the conversion of the FR contracts.

49. The Settlement permitted future changes and growth in each FR shipper's use of the system without an increase in revenue responsibility. Southwest, like all parties to the Settlement, understood when it entered into the Settlement, that its service demands could increase or decrease, and its service demands relative to those of its competitors could change over the 10-year period without a change to its rates or revenue responsibility or a change to the rates and revenue responsibility of its competitors. This is what the Settlement provided for and what the parties bargained for and agreed to. The public interest compelled the Commission's conversion of the contracts from FR contracts to CD contracts to provide for orderly use of the constrained El Paso system, but did not change this pre-existing understanding, and is therefore not a basis for a change in Settlement revenue responsibility.

50. To be sure, the Commission's decision to address the capacity allocation issue and leave the remainder of the Settlement in place was a complex and difficult decision. However, the Commission believes the remedy it chose was the right remedy – the

remedy that most effectively furthered the public interest. This remedy is a reasonable remedy in the context of the circumstances on El Paso, appropriately balances the interests of all the parties, and is consistent with the requirements of the NGA and Commission policy. The Commission has significant discretion to shape equitable remedies to achieve the purpose of our statutory delegation.³¹ In addition, the courts have stated, “the breadth of agency discretion is, if anything, at zenith when the action assailed relates primarily ... to the fashioning of policies, remedies, and sanctions ... to arrive at the maximum effectuation of Congressional objectives.”³² And Congress has recognized that the Commission, not the courts, is best suited to make such determinations in light of its detailed knowledge of industry conditions.³³

The Commission orders:

Southwest’s request for rehearing of the May 26, 2006 Order is denied.

By the Commission. Commissioner Spitzer not participating.

(S E A L)

Kimberly D. Bose,
Secretary.

³¹ See *Columbia Gas Transmission Corp. v. FERC*, 750 F.2d 105, 109 (D.C. Cir. 1984).

³² See *Niagara Mohawk Corp. v. FPC*, 379 F.2d 153, 159 (D.C. Cir. 1967).

³³ See *Columbia Gas Transmission Corp. v. FERC*, 750 F.2d 105, 109 (D.C. Cir. 1984).