UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

El Paso Natural Gas Co. Docket No. RP00-336-031

Aera Energy, LLC, *et al.*, Docket No. RP01-484-005
Complainants
v.
El Paso Natural Gas Co.,
Respondent

Texas, New Mexico and Arizona Shippers,
Complainants Docket No. RP01-486-005
v.
El Paso Natural Gas Co.,
Respondent

KN Marketing, L.P., Docket No. RP00-139-007
Complainant
v.
El Paso Natural Gas Co.,
Respondent

ORDER ON REMAND

(Issued May 26, 2006)

1. On July 9, 2003, the Commission issued an order on rehearing in the above-captioned proceeding.[1] Among other things, the order affirmed the Commission's prior decision to require El Paso Natural Gas Company (El Paso) to convert the contracts of its full requirements (FR) shippers to contract demand (CD) contracts in order to restore

[1] *El Paso Natural Gas Co.*, 104 FERC ¶ 61,045 (2003).

reliable firm service on El Paso. The order also found that reallocation of costs among the FR shippers was not necessary to achieve the goal of restoring reliable firm service on El Paso. The Commission affirmed its ruling on the cost allocation issue in a second order on rehearing issued March 8, 2004.[2]

2. Southwest Gas Company (Southwest) sought judicial review of this aspect of the Commission's orders. 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. As explained below, upon further consideration, the Commission concludes that there is no basis for modifying the Settlement rates during the remaining term of the Settlement, and therefore affirms its prior decision on this issue. The Commission finds that a reallocation of costs is not consistent with section 5 of the Natural Gas Act (NGA) or *Mobile-Sierra*,[3] and would unnecessarily and unjustifiably abrogate the rate certainty provisions of El Paso's 1996 Settlement.

I. Background

3. In the prior orders in this proceeding,[4] the Commission took action to resolve the capacity allocation problems that had rendered firm service on El Paso unreliable. Prior to the issuance of those orders, El Paso had served its firm customers under two types of contracts, *i.e.*, FR and CD contracts. CD contracts provide specific 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 from El Paso, the customer's full natural gas requirements each day. Thus, FR 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.

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

[3] *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). Pursuant to *Mobile-Sierra*, the Commission may exercise its authority under section 5 of the NGA to modify contracts or settlements that it determines are not in the public interest.

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

4. In 1990, El Paso entered into a Settlement (1990 Settlement) with its customers that, among other things, implemented contract conversions from bundled sales service to transportation service. The 1990 Settlement specifically provided for the continuation of FR service.

5. In 1996, El Paso entered into another Settlement with its shippers (1996 Settlement or Settlement) that established the rates and terms and conditions of service that would apply on its system for a ten-year period, *i.e*., until January 1, 2006.[5] The Commission approved the Settlement.[6] At the time the 1996 Settlement was filed, there was substantial excess capacity on El Paso's system. Following the restructuring of the natural gas industry and the unbundling of sales and transportation services, El Paso's California local distribution company (LDC) customers turned back capacity rights in accordance with their contracts and state policy. These California LDCs notified El Paso that they would be turning back substantial quantities of capacity with the result that approximately 35 percent of El Paso's system capacity was to become unsubscribed.

6. In response, El Paso filed a section 4 rate case in which it proposed to allocate the costs of the turned-back capacity to its remaining customers. To address this revenue shortfall without a considerable rate increase to the remaining customers, El Paso and its maximum rate shippers entered into the 1996 Settlement in which they agreed to share the fixed costs of the unsubscribed capacity and also to share the revenues when El Paso recontracted that turned-back capacity. Thus, El Paso's maximum rate shippers agreed to bear 35 percent of the costs of the unsubscribed capacity, and El Paso agreed to credit back to these shippers 35 percent of any remarketing revenues above a threshold level for the first eight years of the Settlement.

7. The 1996 Settlement further provided for rate certainty for the ten-year period in the form of a rate cap. The base settlement rates and charges were capped for ten years, subject to an annual inflation adjustment. In approving the Settlement, the Commission

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[5] El Paso made its section 4 filing to place new rates into effect on its system in Docket No. RP05-422-000. El Paso's filing also proposed a number of new services and new terms and conditions of service. The Commission accepted and suspended El Paso's filing, subject to conditions and the outcome of a hearing and technical conference. 112 FERC ¶ 61,150 (2005). El Paso and its shippers have agreed to delay the implementation of the new services and the related overrun and penalty charges. *See El Paso Natural Gas Co.,* 114 FERC ¶ 61,338 (2006).

[6] *See El Paso Natural Gas Co.*, 79 FERC ¶ 61,028, *reh'g denied,* 80 FERC ¶ 61,084 (1997).

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]

8. As Southwest points out in its request for rehearing of the March 8, 2004 Order, the Settlement rates are 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 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]

9. In its order accepting the 1996 Settlement, the Commission concluded that the Settlement was a reasonable resolution of the excess capacity crisis facing El Paso's system at that time. However, as the Commission explained in the prior orders in this proceeding,[11] during the first several years of the Settlement period, circumstances on El Paso's system changed dramatically. The turned-back capacity was resold, and the full requirements shippers' load grew substantially while their cost responsibility remained at their billing determinant levels.[12] There was no longer sufficient capacity to meet the demands of all firm shippers, causing routine reductions to firm customers' service requests. Firm service on El Paso's system was no longer reliable.

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[7] *Id.* at 61,126.

[8] Request for Rehearing of Southwest Gas, filed August 7, 2003, at p. 10.

[9] *See, e.g.,* May 31, 2002 Order, 99 FERC at 61,998.

[10] *Id.*

[11] *E.g., Id.*

[12] *Id.* at 62,002-03.

10. In response to the routine cuts in firm service that were taking place on the El Paso system, three separate shipper groups filed complaints concerning capacity allocation issues.[13] In addition, the Commission directed El Paso to file a systemwide capacity allocation proposal in El Paso's Order No. 637 proceeding. El Paso complied by filing an allocation plan that proposed to allocate capacity to the FR shippers based on their 1996 Settlement billing determinants.

11. On May 31, 2002, the Commission issued its first order that addressed the complaints and established a framework for resolving the capacity allocation problems on El Paso.[14] To restore reliable firm service on El Paso, the May 31, 2002 Order, among other things, directed El Paso to convert service under full requirements contracts to service under contracts with specific contract demand limits up to El Paso's available capacity so that service to one firm shipper would not adversely affect firm service to others. The Commission explained that while there was no single cause of the capacity allocation crisis on the El Paso system, the unlimited growth in use of the system under the FR contracts was a significant factor, and any solution to the problem required a limit on future growth under the FR contracts.[15]

12. In the May 31, 2002 Order, the Commission discussed the various proposals for allocating capacity among the FR shippers,[16] and rejected El Paso's proposal to allocate capacity to the FR shippers at their billing determinant level. The Commission stated that while billing determinants determined the Settlement cost allocation to the FR shippers,

[13] In *KN Marketing, L.P. v. El Paso*, Docket No. RP00-139-000, KN Marketing alleged that El Paso's allocation of firm mainline capacity on the east end of its system was unjust and unreasonable because El Paso sold firm capacity in excess of the available capacity. In *Joint Complainants v. El Paso*, Docket No. RP01-484-000, a group of El Paso's California CD customers alleged that El Paso had oversold its firm capacity and that this, combined with the growth of the demand of the FR customers, had resulted in unjust and unreasonable services on the El Paso system. In *Texas, New Mexico, and Arizona Shippers v. El Paso*, Docket No. RP01-486-000, a group of El Paso's full requirements customers alleged that El Paso had violated the NGA by failing to maintain its facilities in a manner that allowed it to provide firm service up to certificated levels.

[14] May 31, 2002 Order, 99 FERC ¶ 61,244 (2002).

[15] *Id.* at 62,002-03.

[16] *Id.* at 62,008-09.

they did not and were not intended to reflect those shippers' use of the system.[17] The Commission found that a reasonable allocation method should reflect the FR shippers' then-current use of the system within the system capacity.

13. The Commission found that modification of the 1996 Settlement was in the public interest, to the extent necessary to restore reliable firm service. However, the Commission modified the Settlement only to the extent necessary to restore reliable firm service on El Paso, and stated that the remainder of the Settlement would remain in place.[18] The conversion of FR service to CD service became effective on September 1, 2003.

14. The Commission's decision was affirmed by the court in *Arizona Corporation Commission v. FERC*.[19] In upholding the Commission's decision, the court found that the Commission had reasonably concluded that the unrestricted growth rights under the FR contracts posed an unusual threat to the public interest.[20] The court also rejected the arguments of petitioners that the Commission was arbitrary and capricious in selecting a remedy for the problem, stating that the Commission wields maximum discretion in selecting a remedy.[21] The court stated that, contrary to the petitioners' assertion that they had been left with access to less natural gas than their historic needs demanded, in fact, the Commission "assigned each FR customer (but one) capacity – *priced at the Settlement rates* – in excess of its 2001 non-coincident peak demand…."[22]

II. Prior Determination on Reallocation of Costs

15. In the May 31, 2002 Order, the Commission stated that it had attempted to minimize the changes to the Settlement while taking action to alleviate the service reliability problems on the system, and that it therefore did not propose to modify the Settlement rates. However, in the September 20, 2002 Order, the Commission directed El Paso to reallocate the aggregate FR revenue responsibility among the FR shippers pro

[17] *Id.*

[18] May 31, 2002 Order, 99 FERC at 62,018.

[19] 397 F.3d 952 (D.C. Cir. 2005).

[20] *Id.* at 956.

[21] *Id.*

[22] *Id.* (Emphasis added).

rata based on their new CD levels.[23] The Commission stated that this would ensure that each FR shipper paid for the service it received. 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.

16. In the July 9, 2003 Order on rehearing, the Commission reconsidered and reversed the September 20, 2002 ruling on the cost reallocation issue. 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 stated that reallocation of costs would go beyond this narrow purpose, and would unnecessarily disturb the parties' settlement bargain.

17. Southwest sought rehearing of this portion of the July 9, 2003 Order.[24] Southwest argued that the Commission erred in failing to require a reallocation of revenue responsibility and had thereby placed Southwest at a competitive disadvantage by changing the relationship between service entitlements and revenue responsibility. Southwest stated that its unit rate 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).

18. In the March 8, 2004 Order on rehearing, the Commission denied Southwest's request for rehearing. The Commission explained that the difference in effective unit rates among 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, the Settlement permitted changes in the FR shippers' use of the El Paso system with no change in revenue responsibility.

19. Southwest sought judicial review of the Commission's ruling on the cost allocation issue. 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. The Commission has given further consideration to Southwest's concerns, but, as explained below, the Commission again concludes that a reallocation of costs among the FR shippers in these circumstances is not justified. Thus, the Commission concludes that

[23] September 20, 2002 Order, 100 FERC ¶ 61,285 at P 33.

[24] BHP Copper also filed a request for rehearing.

the retention of the Settlement rates for the remainder of the Settlement period is consistent with section 5 of the NGA, with *Mobile-Sierra*, and appropriately retains the bargains of the parties to the Settlement to the greatest extent possible.

III. Discussion

20. The remedy adopted by the Commission 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 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, at the Settlement rate to which it had agreed and which it had been paying. Thus, the Commission's remedy simply maintained the status quo on the system for the remainder of the Settlement period because the Settlement did not envision the level of growth that occurred in FR demand and there was not enough available capacity on the El Paso system to allow continued growth in demands under the FR contracts. The court affirmed the Commission's allocation of capacity to the former FR shippers, stating that these allocations exceeded each FR customer's (except one) 2001 non-coincident peak demand.[25]

21. The courts have recognized that the Commission's discretion is "at its zenith" when it is fashioning a remedy.[26] In this case, the Commission's remedy resolved the capacity allocation crisis on the system by addressing its cause and, consistent with the policy favoring settlements, preserved the remainder of the Settlement. This is a reasonable remedy and appropriately balances the interests of all the parties to the Settlement. Thus, as explained more fully below, the Commission concludes that a reallocation of costs among the FR shippers is not justified.

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

22. Southwest argues the Commission's orders in this proceeding fail to comply with the requirements of section 5 of the NGA because the Commission did not establish just and reasonable rates on El Paso. Southwest states that section 5 of the NGA imposes two obligations on the Commission. First, Southwest asserts, under section 5, the Commission must find that the status quo is unjust and unreasonable, and, second, the Commission must develop an end result that is just and reasonable. Southwest asserts that the Commission failed to meet this second requirement of section 5 because, after it

[25] *Arizona Corporation Comm. v. FERC*, 397 F.3d at 956.

[26] *Id. See* also *Niagara Mohawk Power Corp. v. FPC,* 379 F.2d 153, 159 (D.C. Cir. 1967) (the breadth of Commission discretion is, if anything, at its zenith when fashioning remedies).

determined that the capacity allocation methodology in place on El Paso was unjust and unreasonable and contrary to the public interest, it failed to determine just and reasonable rates on the El Paso system. [27]

23. Contrary to Southwest's assertion, the Commission met its section 5 responsibility in this proceeding. The Commission's finding that the capacity allocation system on El Paso was contrary to the public interest required the Commission to establish an allocation methodology that was just and reasonable and in the public interest. This finding did not, however, require the Commission to abrogate any other part of the Settlement, and it did not require the Commission to establish new rates on El Paso for the remainder of the Settlement period. Rather, the Commission concluded that Settlement rates remained fair and reasonable for the remainder of the term of the Settlement.

24. In its prior orders in this proceeding, the Commission specifically addressed the question of whether, instead of making only these limited changes to the Settlement, it should abrogate the entire Settlement. Several of the former FR shippers argued that once the Commission had decided to modify the 1996 Settlement in part, it erred by failing to terminate the Settlement in its entirety because the Commission's actions had eliminated the benefits of the Settlement for the FR shippers. In addition, one of the historic CD shippers (SoCalEdison) argued that the Commission should abrogate the entire Settlement because the Commission's actions had benefited the FR shippers by giving them preferential rates. The Commission rejected these arguments and concluded that the facts and the law did not support abrogation of the entire Settlement.[28] The Commission stated that it would modify the Settlement only to the extent necessary to restore reliable firm service on El Paso.

25. Further, in El Paso's pending rate case in Docket No. RP05-422-000, El Paso argued that the 1996 Settlement was a non-severable package deal that was fundamentally altered to El Paso's detriment. El Paso argued that, therefore, its obligations under Article 11 of the Settlement[29] were no longer applicable. The Commission rejected El Paso's argument and stated that nothing in the remedy adopted

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[27] Southwest cites *Interstate Natural Gas Ass'n v. FERC*, 285 F.3d 18, 37 (D.C. Cir. 2002); *Consolidated Edison Co. v. FERC*, 165 F.3d 992, 1001 (D.C. Cir. 1999); *Municipal Defense Group v. FERC*, 170 F.3d 197, 201 (D.C. Cir. 1999); *Public Service Commission v. FERC*, 866 F.2d 487, 488 (D.C. Cir. 1989).

[28] *See* May 31, 2002 Order, 99 FERC at 62,003. This determination is now final and non-appealable.

[29] Article 11 of the Settlement places certain limitations on the rates that El Paso can charge in future rate cases to shippers that were parties to the 1996 Settlement.

in this proceeding changed El Paso's obligations under other provisions of the Settlement. The conversion of FR contracts on El Paso to CD contracts does not require an establishment of new rates on El Paso, any more than it required the Commission to abrogate the entire Settlement or relieve El Paso from its obligations under the Settlement.

26. The cases cited by Southwest are not to the contrary. These cases merely stand for the proposition that an existing rate must be shown to be unjust and unreasonable before the Commission can act under section 5 of the NGA to replace the existing rate with a different rate. There is nothing in the Commission's action in this proceeding that is inconsistent with this principle. In this case, the Commission examined the capacity allocation practices on El Paso's system and found that the allocation methodology was contrary to the public interest. It then replaced that methodology with one that was in the public interest. This is fully consistent with the Commission's obligations under section 5 of the NGA.

27. In explaining its decision not to modify the Settlement rates, the Commission stated that the Commission's section 5 action under *Mobile-Sierra* in this proceeding was narrow, and was intended to remedy the service interruptions that had rendered firm service on El Paso unreliable.[30] Southwest objects to the Commission's conclusion that it would modify the Settlement only to the extent necessary to restore reliable firm service on El Paso, and argues that the Commission cannot evade its section 5 responsibilities by simply asserting this "narrow purpose." Southwest cites the May 31, 2002 Order which states that "it is the Commission's responsibility in the first instance, to decide whether the modification of the contracts is in the public interest *taking all factors into account*, including whether maintaining the status quo "casts upon other consumers an excessive burden or is unduly discriminatory."[31] Thus, Southwest argues, the Commission was required to take all factors into account, rather than merely assert a narrow purpose. Similarly, Southwest argues that the Commission cannot evade its section 5 responsibility by asserting that a cost reallocation would unnecessarily disturb the parties' settlement bargain.

28. The Commission finds that the decision to disturb the Settlement only to the extent necessary to resolve the capacity allocation crisis on the El Paso system is consistent with the Commission's policy favoring settlements, as well as with the requirements of *Mobile-Sierra*. Preserving the bargains of the parties to the greatest extent possible encourages settlements. Parties would be hesitant to resolve their disputes by settlement if the Commission did not honor those agreements to the greatest extent possible, and instead frequently modified or abrogated settlements during their terms. Therefore, the

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[30] *See* July 9, 2003 Order, 104 FERC ¶ 61,045 at P95; 106 FERC ¶ 61,233 at P 14.

[31] May 31, 2002 Order, 99 FERC at 62,006 (2002).

Commission is reluctant to modify a settlement while it is in effect, but found that extraordinary circumstances on El Paso's system required such modification. In addition, as discussed below, under *Mobile-Sierra*, the Commission cannot alter the Settlement rates unless it can be shown that the abrogation of the Settlement rates meets the higher public interest standard.

29. In addition, Southwest's argument that the Commission must now undertake a review of 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 of sections 4 and 5 of the NGA and rates established pursuant to uncontested settlements. These Settlement rates were agreed to by all the parties and represent a compromise related to a number of issues in the 1996 Settlement. The rates do not directly correlate to capacity rights.

30. The Commission does not apply the just and reasonable standard when approving rates under uncontested Settlements, but instead applies a less stringent standard and determines whether the uncontested settlement rates are fair and reasonable and in the public interest. Thus, the Commission approved the 1996 Settlement rates as fair and reasonable and in the public interest. The courts have affirmed that in ruling on an uncontested settlement, the Commission may approve uncontested settlement rates as fair and reasonable and in the public interest without a determination on the merits that the rates are just and reasonable.[32]

B. <u>The Elimination of FR Service Does Not Require a Change in the Settlement Rates</u>

30. Southwest further argues that, in the specific circumstances of this Settlement, the elimination of the FR service requires a change in the rates paid by the FR shippers. Southwest argues that the elimination of FR service on El Paso has rendered the Settlement rates unjust, unreasonable and unduly discriminatory, and establishes relationships between service and rates that were not created by the Settlement. Southwest also asserts that maintenance of the Settlement rates does not in fact minimize changes to the Settlement, as stated by the Commission, but is contrary to the purposes of the Settlement.

31. As discussed below, the Commission finds that the maintenance of the Settlement rates does not change the relationship between rates and service for the FR shippers, but instead preserves that relationship for the remainder of the term of the Settlement. In addition, we find that the maintenance of the Settlement rates is not contrary to the purposes of the Settlement, and appropriately balances the interests of all the parties to the Settlement.

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[32] *E.g., United Municipal Distributors Group v. FERC*, 732 F.2d 202, 209 (1984).

1. **Relationship Between Rates and Services**

32. Southwest argues that the elimination of FR service on El Paso changes the relationship between rates and services provided for in the Settlement. Further, Southwest states that based on the CD levels allocated to the FR customers in converting their service to CD service, Southwest will be charged a higher effective unit rate than two of its similarly-situated competitors, APS/Pinnacle and Salt River Project. Southwest states that Appendix D of the July 9, 2003 Compliance Order "assigns" it a billing determinant of 329,754 Mcf/d, or approximately 44.1 percent of the total East of California (EOC) billing determinants. At the same time, Southwest asserts, it is assigned a peak month CD of 727,950 Mcf/d, approximately 26.8 percent of the total peak month CDs. By way of comparison, Southwest asserts, APS/Pinnacle is assigned a billing determinant of 64,557 Mcf/d, or 8.6 percent of the total, and is assigned a peak month CD of 375,888 Mcf/d, 13.8 percent of the total. Southwest computes its unit rate for firm service to Arizona as $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.

33. Thus, Southwest states, the Commission is requiring Southwest to pay a rate that is many times the rate of other similarly situated El Paso customers, and has not explained why this is a just and reasonable result. Southwest asserts that it is harmed competitively by the Settlement rates because it is less able to compete in the primary and secondary markets. Southwest states that with a cost reallocation, it would receive a savings of $11-$13 million annually.

34. Contrary to Southwest's assertion, the Commission's action in this proceeding did not change the relationship between service and rates on El Paso, and, as explained in the March 8, 2004 Order,[33] the Commission did not "establish" rates. Nor did the Commission "assign" Southwest, or any other FR shipper, a billing determinant. The billing determinants included in Appendix D of the July 9, 2003 Compliance Order[34] are the Settlement billing determinants agreed to by Southwest and all of the parties to the Settlement. The amount of capacity allocated to each former FR customer is based on the amount of system capacity the customer was taking under the Settlement pursuant to its FR contract. Each former FR customer's new CD is 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. Thus, instead of changing the relationship between service and rates on El Paso, as Southwest asserts, the

[33] 106 FERC ¶ 61,233 at P 22.

[34] 104 FERC ¶ 61,044.

Commission's action in this proceeding locked into place, for the remainder of the Settlement period, the relationship between service and rates that existed on El Paso under the Settlement at the time of the conversion of the FR contracts.

35. The difference in the "effective unit rates" calculated by Southwest results from the operation of the terms of the Settlement, not the Commission's decision to convert the FR contracts to CD contracts. Under the terms of the Settlement, the FR contracts permitted future growth in each FR shipper's use of the system without an increase in revenue responsibility. Accordingly, the Settlement billing determinants were not premised on any particular volume of service to the FR shippers, and each FR shipper could change its volumes without a change in its rates. During the course of the Settlement, some FR shippers' use of the system grew more under their FR contracts than others',[35] but it was never contemplated that the FR shippers' different levels of use of the system would change their revenue responsibility.

36. Therefore, under the 1996 Settlement, there was no provision or intent that the initial relationship between revenue responsibility and system usage would be maintained throughout the term of the Settlement. On the effective date of the 1996 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 on the El Paso system increased or decreased. The Settlement bargain did not establish unit rates for the FR shippers, but provided that each FR shipper's billing determinant would remain constant as its capacity demands on the system changed. It was never contemplated that the Settlement rates would be modified during the term of the Settlement to maintain any particular effective unit rate for any FR shipper.

37. Southwest, like all parties to the Settlement, knew 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. There was no suggestion or reasonable expectation that each FR shipper's demands would change uniformly or proportionately. Customers that had the highest rate of growth under their contracts during the term of the Settlement would have effective unit rates that were lower than the effective unit rates of other shippers whose loads grew less. This is what the Settlement provided for and what the parties bargained

[35] A comparison of shippers' Settlement billing determinants and their peak month allocated CDs provides a rough estimate of those shippers' growth. Southwest's CD is 221 percent higher than its billing determinants, while APS's CD is 582 per percent higher, and Salt River Project's is 859 percent higher than their respective billing determinants.

for and agreed to. The Commission's conversion of the contracts from FR contracts to CD contracts did not change this and is therefore not a basis for a change in Settlement revenue responsibility.

38. Because the amount of capacity allocated to each former FR customer was based on its use of the system, Southwest, like every other FR shipper, was paying the same "effective unit rate" after the conversion of the FR contracts to CD contracts, as it was paying before the conversion. There would have been no basis prior to the conversion of the FR contracts for Southwest to object to the Settlement rates to which it had agreed merely because other FR shippers had experienced a higher rate of growth than Southwest. There is no more basis now for increasing the Settlement rates of the other FR shippers than there was prior to the conversion of the FR contracts.

39. Thus, the Commission's action did not affect the competitive positions of any of the FR shippers in relationship to each other in the primary market. Southwest also argues, however, that the Commission's decision alters the ability of former FR shippers to recover or offset their capacity costs through capacity release.[36] Southwest states that it competes against other El Paso customers in the capacity release market, and that it is at a disadvantage in that market if it pays a higher effective unit rate than other shippers. Further, Southwest Gas objects to the Commission's orders because they changed the amount of capacity that is available for each shipper to release. Prior to the conversion of the FR contracts, and consistent with Commission policy, each FR shipper could release capacity up to its billing determinant. After conversion, the former FR shippers may now release capacity up to their new CD levels. Southwest argues that this permits its competitors with higher CD levels to release a greater amount of capacity and, thus, recoup a larger amount of their costs.

40. As the Commission acknowledged in the March 8, 2004 Order, Southwest is correct that, based on their then-current use of the system, APS and Salt River Project were allocated a greater percentage increase in capacity above their billing determinants than was Southwest, and, therefore, theoretically could release more capacity than Southwest. However, as the Commission has explained, its capacity release regulations were designed to allow pipeline customers paying straight fixed variable (SFV) rates to mitigate the costs of holding firm capacity and are intended to promote competition and the efficient use of pipeline capacity by allowing shippers to release unneeded capacity to other shippers in competition with the pipeline's capacity.[37] The regulations do not

[36] The Commission's regulations permit pipeline customers with excess firm capacity to release that capacity to other shippers. 18 C.F.R. § 284.8 (2005).

[37] *See, e.g.*, *South Gulf Pipeline Co.*, 104 FERC ¶ 61,160 at P 29 (2003).

guarantee that any shipper will be able to release all the capacity it wants to release at any specific rate, or that it will be able to recoup as much of its costs as other shippers who release their capacity.

41. Further, in the March 8, 2004 Order, the Commission stated that, in view of the FR customers' assertions that their needs for capacity were increasing and their concerns that they would have insufficient capacity to meet their needs, any capacity available for release would be minimal. The conclusion that any potential inequality is minimized by the circumstances on El Paso is based on the record in this proceeding. Throughout this proceeding, the former FR shippers stated that their demands on the El Paso system were increasing, not decreasing, and these shippers stated that they were concerned that they would not have sufficient capacity to meet their obligations.[38] For example, in its request for rehearing of the May 31, 2002 Order, APS/Pinnacle stated that in view of the rapid increase in demand in the state of Arizona, the capacity allocated by the Commission would be inadequate to meet FR shipper needs.[39] In addition, the Commission based its capacity allocations to the former FR shippers on actual past usage on a monthly, rather than annual, basis, so that each FR shipper was allocated less capacity in its off-peak months. It is reasonable in these circumstances to expect that the former FR customers would not have large amounts of capacity to sell in the release market.

42. Thus, based on the statements of the FR shippers, the Commission had a reasonable basis for concluding that capacity release by the former FR shippers during the remainder of the Settlement period would be minimal. Further, there is no right on the part of any shipper to be able to release any particular volume of capacity at any particular price. In these circumstances, abrogating the Settlement rates in order to reallocate costs among the FR shippers to facilitate capacity release for Southwest is not justified.

2. <u>The Commission Properly Minimized Changes to the Settlement</u>

43. Southwest argues that while the Commission has stated that its remedy minimized changes to the Settlement, its action is actually inconsistent with the terms of the Settlement. As discussed below, the Commission's remedy in this proceeding honors the Settlement bargains to the maximum extent possible consistent with the public interest.

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[38] *See, e.g.,* July 9, 2003 Order, 104 FERC ¶ 61,045 at P 52.

[39] *See id.*

a. **Non-Severable Package**

44. Southwest argues that the provisions of the 1996 Settlement were a non-severable package deal, and notes that all parties had the right to withdraw from the Settlement in the event of modifications or conditions ordered by the Commission prior to the implementation of the Settlement. Southwest states that the Commission's elimination of FR service was not contemplated by the 1996 Settlement, and that there is no indication that El Paso's customers would have agreed to the continuation of the Settlement revenue responsibility absent continuation of FR service. Therefore, Southwest states, the Settlement provides no support for the notion that substituting CD service for FR service without adjusting the allocation of revenue responsibility to reflect the new fixed entitlement is consistent with the Settlement.

45. The Commission recognizes that this Settlement was a package of bargains and that any party could withdraw from the Settlement prior to its implementation if the Commission modified the Settlement prior to approval. However, the fact that the Settlement contains in Article 17 a fairly standard provision that would have allowed El Paso to withdraw the Settlement prior to its implementation if the Commission's approval modified the Settlement in a significant way, does not mean that a party can withdraw from the Settlement bargains some eight years after the Settlement was implemented.[40] Once the Settlement was implemented, all parties were bound by it, and the Settlement cannot be changed absent Commission action under section 5 of the NGA.

46. We recognize the Settlement was a package involving compromises on a number of issues, and the parties might not have agreed to the Settlement in 1996 if all elements were not present. But, it does not follow that the Commission therefore cannot, some six years later when the circumstances that prompted the Settlement had changed, exercise its authority as it did here, consistent with the *Mobile-Sierra* public interest standard, to change one portion of the Settlement that has become contrary to the public interest. 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. As we have explained, under the circumstances here, the conversion of FR contracts to CD contracts does not also necessitate reallocating costs among converting shippers.

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[40] In *El Paso Natural Gas Co.*, 89 FERC ¶ 61,164 at 61,493 (1999), the Commission held that a party could not withdraw its approval of this Settlement simply because the Settlement had not been as beneficial as it had thought when it agreed to the Settlement.

b. Uniform Zonal Rates

47. Southwest states that the Commission erred in concluding that reallocation of cost responsibility among the FR shippers would unnecessarily disturb the parties' Settlement bargain because, while the Settlement contains billing determinants for each FR customer that would be changed in a Commission- mandated cost reallocation, the Settlement also includes zonal rates for firm service to Arizona, New Mexico and Texas, which would change if the Commission does not mandate cost reallocation. Southwest argues that these uniform zonal rates establish the parties' intent that each CD customer should pay the same rate for service within the same zone. Southwest argues that the Commission's remedy, creating new CD customers, all of whom are paying different effective unit rates, is inconsistent with that intent. Southwest argues that the Commission has not justified why the intent of the parties that all CD shippers in the same zone pay the same unit rate for the right to demand firm CD service is any less a part of the Settlement bargain than the billing determinants.

48. The Commission finds that it was not the intent of the parties to the Settlement that the FR shippers pay the same zonal rate as the CD shippers. The 1996 Settlement established zonal rates for FT-1 service, but these were not the rates paid by the FR shippers. As explained above, the FR shippers agreed to a fixed annual revenue requirement from which the monthly payments were derived.

49. Moreover, in converting the FR contracts to CD contracts, the Commission did not treat the converted FR shippers as though they were similarly situated to the historic CD shippers after conversion. Instead, the Commission took a number of actions to alleviate the impact of the FR conversion on the FR shippers and to assure that these shippers would have capacity available to meet their needs.[41] The former FR shippers and the historical CD shippers are not similarly situated[42] and there is no basis for suggesting that these two classes of shippers should pay the same rates.

50. While it was never contemplated that FR shippers and CD shippers would pay the same rates, rate certainty was an important part of the parties' bargain. Southwest may now be willing to trade its bargain of rate certainty for lower rates for itself, but is it not fair or consistent with the Commission's policy favoring settlements to require other FR

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[41] For example, the Commission directed El Paso to make additional capacity available to the former FR customers through its Line 2000 Power-Up Project, acceptance of turnback capacity, and use of California delivery points as receipt points. In addition, the Commission directed El Paso to establish a capacity pool for FR shippers to ensure that all of their capacity needs would be met. 104 FERC ¶ 61,045 at P 8-10.

[42] July 9, 2003 Order, 104 FERC ¶ 61,045 at P 115-117.

shippers to trade their bargain of rate certainty for higher rates. The FR shippers agreed to a specific level of revenue responsibility that would not change for the 10-year Settlement period. This revenue responsibility was agreed to by all shippers and has been relied upon by them. Retaining the Settlement rates for the remainder of the Settlement period, *i.e*., until the end of the Settlement period on December 31, 2005, appropriately balances the interests of all of the parties to the Settlement.

c. Modification of the Settlement Rates is Not Justified Under the *Mobile-Sierra* Doctrine

51. As explained above, the Commission's determination that the capacity allocation methodology in effect on El Paso was no longer in the public interest does not in and of itself require a reallocation of rates under the Settlement. The issue therefore is whether there is a basis under the higher public interest standard of *Mobile-Sierra* to conclude that the Settlement rates are no longer in the public interest and to prescribe different rates for all of the parties to the Settlement.

52. In the May 31, 2002 Order in this proceeding, the Commission found that any changes to this Settlement must be consistent with the higher public interest standard of *Mobile-Sierra*.[43] Southwest was among the parties that argued to the Commission that any change to the Settlement must be justified under the higher public interest standard of *Mobile-Sierra*.[44] In affirming the Commission's decision, the court found that the changes to the Settlement ordered by the Commission must meet the *Mobile-Sierra* public interest standard. The court concluded that the Commission had met that standard and had not merely protected one of the parties to the Settlement from an improvident bargain, but had "exercised its *Mobile-Sierra* authority to prevent 'the imposition of an excessive burden' on third parties."[45] Further, the court found that the Commission could reasonably find that the FR contracts posed "an unusual threat to the public interest."[46]

[43] 99 FERC at 62,004.

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

[45] *Arizona Corporation Commission v. FERC*, 397 F.3d at 954.

[46] *Id.* at 955.

53. Therefore, any proposed modification to the Settlement rates must be evaluated under the public interest standard of *Mobile-Sierra*. As Southwest stated in its comments on El Paso's capacity allocation proposal,[47] the public interest standard under *Mobile-Sierra* is higher and more difficult to meet than the statutory "unjust and unreasonable" standard. The public interest is not the same as the interests of the parties to the Settlement, and the Commission does not protect parties from the consequences of their bargains.[48] Therefore, contract modification is not justified on grounds that a contract has become uneconomic for one of the parties, and "the parties may be required to live with their bargains as time passes and various projections about the future are proved correct or incorrect."[49] Contract modification is also not justified under *Mobile-Sierra* on grounds that some shippers pay a different rate under a contract or settlement agreement than other shippers on the system.[50]

54. In the prior orders in this proceeding, the Commission found that extraordinary circumstances existed on El Paso that required the Commission to exercise its authority under section 5 of the NGA to convert FR service to CD service in the public interest to restore reliable firm service on El Paso. The extraordinary circumstances that required such action related to routine cuts in firm service that were experienced by all shippers on El Paso.

55. Southwest has not shown any harm to the public interest from continuing the Settlement rates for the term of the Settlement. It has merely argued that it has been disadvantaged with respect to other FR shippers. This is not a sufficient basis for disturbing the rate certainty that was a significant part of the Settlement bargain for all parties.

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

[48] July 9, 2003 Order, 104 FERC ¶ 61,045 at P 42 (citing *FPC v. Sierra Pacific Power Co*, 350 U.S. at 350) and P 43 (citing *Nevada Power Co. and Sierra Pacific Power Co. v. Enron Power Marketing, Inc.*, 103 FERC ¶ 61,353 (2003)); *Public Utilities Commission of California v. Sellers of Long-Term Contracts*, 103 FERC ¶ 61,354 (2003); *PacifiCorp v. Reliant Energy Services, Inc*., 103 FERC ¶ 61,355 (2003)).

[49] *Town of Norwood v. FERC,* 587 F.2d 1306, 1312 (D.C. Cir. 1978). *See also, Public Utilities Comm'n of California v. FERC,* 894 F.2d 1372, 1383 (D.C. Cir. 1990) (Reliance on a settlement "outweighs the value of being able to correct for decisions that in hindsight may appear unsound.")

[50] *See, e.g., Potomac Electric Power Co. v. FERC*, 210 F.3d 403, 409 (D.C. Cir. 2000); *Cities of Bethany v. FERC,* 727 F.2d 1131, 1139 (D.C. Cir. 1984); *United Municipal Distributors Group v.* FERC, 732 F. 2d 202 (D.C. Cir. 1984).

<u>The Commission orders:</u>

The Commission affirms its prior finding that the 1996 Settlement rates should remain in effect during the Settlement period.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.