

133 FERC ¶ 61,104
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

El Paso Natural Gas Company

Docket No. RP10-1398-000

ORDER ACCEPTING AND SUSPENDING TARIFF RECORDS SUBJECT TO
REFUND AND CONDITIONS AND ESTABLISHING HEARING PROCEDURES

(Issued October 29, 2010)

1. On September 30, 2010, El Paso Natural Gas Company (El Paso) filed revised tariff records proposing a rate increase for existing services and changes to certain terms and conditions of service. El Paso filed primary and alternate tariff records¹ and proposes an effective date of November 1, 2010.² As discussed below, the Commission will accept and suspend El Paso's primary tariff records, to be effective April 1, 2011, subject to refund and conditions and the outcome of the hearing established in this order. The Commission will reject the alternate tariff records.

Background

2. On June 30, 2008, in Docket No. RP08-426-000, El Paso filed a general system-wide rate case in which it proposed new services, a rate increase, and changes to certain terms and conditions of service (2008 Rate Case). On March 11, 2010, El Paso submitted a partial settlement agreement (2008 Rate Case Settlement) which included "black box" settlement rates, a revenue sharing mechanism, limited discounts under Rate Schedule IHSW (Interruptible Hourly Swing Service), provisions allowing for the

¹ The primary tariff records were filed as Option A and the alternate tariff records were filed as Option B.

² Paragraphs 13.2 and 13.4 of the 2008 Rate Case Settlement provide that El Paso may file a new section 4 general rate filing for rates to be effective as early as April 1, 2011 and must file for rates to be effective no later than April 1, 2012 (*El Paso Natural Gas Co.*, 131 FERC ¶ 61,077 (2010) (2008 Rate Case Settlement)). El Paso states that an effective date of April 1, 2011 assumes a September 30, 2010 filing date, a five-month suspension period and a thirty-day notice period.

aggregation/disaggregation of contracts for purposes of calculating overrun charges, and certain modifications to the penalty crediting mechanism.³ The 2008 Rate Case Settlement reserved four issues for hearing:⁴ (1) the appropriate capital structure to be used for ratemaking purposes, (2) recovery of Line 1903 costs, (3) value-based rates for short-term firm and certain interruptible services, and (4) certain issues related to Article 11.2 of the 1996 Settlement.⁵ The 2008 Rate Case Settlement also provided for the formation of working groups to study the implications and possible development of (1) a penalty exception(s) in the event of a *force majeure* situation, (2) the design of a “Western End” rate option, and (3) potential tariff changes supporting a shipper’s ability to release premium service capacity and service rights. The 2008 Rate Case Settlement required El Paso to file a new section 4 rate case for rates to be effective no earlier than April 1, 2011 and no later than April 1, 2012.

El Paso’s Filing

3. El Paso states that it proposes an increase in base tariff rates primarily due to a decline in throughput, and degradation of prices received for short-term services and long-term contract renewals on its system. El Paso states that it proposes an average increase to its Rate Schedule FT-1 rates of 32 to 38 percent. El Paso states that it has sought to minimize the rate increase. First, El Paso states that it proposes to continue its existing mainline depreciation rate of 2.2 percent and storage rate of 1.09 percent, even though it contends that higher depreciation rates can be justified. El Paso states that its proposed total cost of service is approximately \$613 million, which is less than the cost of service filed in its last general rate case in Docket No. RP08-426-000 and less than the \$615 million 2010 revenue sharing threshold amount set forth in the 2008 Rate Case Settlement. Second, El Paso states that it has taken a substantial risk position in its billing determinants and revenue assumptions for its short-term interruptible and miscellaneous services. Third, El Paso states that it plans to seek to permanently abandon certain compression facilities on its system⁶ and also file for temporary abandonment of

³ 2008 Rate Case Settlement, 131 FERC ¶ 61,077.

⁴ The initial decision in the Docket No. RP08-426-000 proceeding is due to be issued by November 19, 2010.

⁵ See *El Paso Natural Gas Co.*, 79 FERC ¶ 61,028, *reh’g denied*, 80 FERC ¶ 61,084 (1997). Article 11.2 of the 1996 Settlement contains provisions applicable to the rates to be paid by certain shippers in the post-settlement period, i.e., after December 31, 2005.

⁶ See El Paso’s abandonment application in Docket No. CP10-510-000, filed September 28, 2010.

several other compression units. El Paso states that the resulting lower costs of these abandonments are reflected in El Paso's proposed rates by way of a voluntary reduction to its cost of service of approximately \$20 million.

4. El Paso proposes to continue to use a straight-fixed variable and zone of delivery rate design, but proposes to equalize the rates of its Arizona, Nevada, and California delivery zones. El Paso proposes to include short-term, value-based rates using the same methodology as proposed in the 2008 Rate Case.⁷ El Paso states that it is proposing to offer lower rates to firm shippers with contracts with at least a ten-year term with a termination date of no earlier than April 1, 2021.

5. El Paso submitted primary and alternate tariff records that reflect different methods of allocating certain facility costs to Article 11.2(a) contracts.⁸ The primary tariff records include rates applicable to Article 11.2 contracts that do not exceed the amount calculated pursuant to Article 11.2(a) of the 1996 Settlement. The alternate tariff records include rates applicable to Article 11.2 contracts that exceed the amount calculated pursuant to Article 11.2(a) to reflect an allocation of certain facilities costs, consistent with El Paso's interpretation of Commission orders that provide for the recovery of those expansion costs from "all shippers."⁹

6. El Paso states that it proposes various relatively minor updates to its general terms and conditions of service that do not represent a fundamental change to the service and penalty structure currently in place on El Paso's system. The proposed changes include (1) the addition of third party charge provisions allowing for flexibility on acquired third party pipeline capacity; (2) an update to contract paths to reflect the operational boundaries of El Paso's south system; and (3) an update to the flow day diversion process at delivery points to allow for gas flows to a different rate zone.

7. El Paso states that the 2008 Rate Case Settlement provided for the formation of various working groups comprised of El Paso and representatives of interested settling parties. El Paso states that the purpose and results of each working group are detailed in the instant filing, as required by the 2008 Rate Case Settlement.

⁷ El Paso states that its proposal to continue use of this rate structure is pending the Commission's ruling on this issue in the 2008 Rate Case. The short-term rate was one of the four issues set for hearing in the 2008 Rate Case.

⁸ El Paso also submitted *pro forma* tariff records showing the rates that would apply if, as a result of any future Commission or court order, Article 11.2 is terminated or the rates produced by Article 11.2 are found unjust and unreasonable.

⁹ El Paso cites *El Paso Natural Gas Co.*, 114 FERC ¶ 61,290, at P 69 (2006).

8. El Paso notes that Texas Gas Service Company, a shipper on the El Paso system, submitted a complaint under section 5 of the Natural Gas Act in Docket No. RP10-951-000, alleging that the rate design for El Paso's fuel rate is unjust and unreasonable. Consistent with the answer it filed to the complaint, El Paso states that it continues to believe that it is more appropriate and efficient for the Commission to decide all rate design issues, for both fuel and transportation rates, based on the same data. Therefore, if the Commission does not reject the complaint, El Paso states that the complaint should be consolidated with this rate case proceeding. El Paso states that it will file a formal request to consolidate the proceedings shortly.

Public Notice, Interventions, and Protests

9. Public notice of El Paso's filing was issued on October 4, 2010. Interventions and protests were due as provided in section 154.210 of the Commission's regulations (18 C.F.R. § 154.210 (2010)). Pursuant to Rule 214 (18 C.F.R. § 385.214 (2010)), all timely filed motions to intervene and any motions to intervene out-of-time filed before the issuance date of this order are granted. Granting late intervention at this stage of the proceeding will not disrupt the proceeding or place additional burdens on existing parties. Protests or comments were filed by the Arizona Corporation Commission; Arizona Electric Power Cooperative, Inc.; Arizona Public Service Company; the Electric Generator Coalition; El Paso Electric Company; El Paso Municipal Customer Group; Freeport-McMoRan Corporation and Apache Nitrogen Products, Inc.; Gila River Power, L.P.; Golden Spread Electric Cooperative, Inc.; the Indicated Shippers;¹⁰ MGI Supply Ltd.; New Harquahala Generating Company, LLC; New Mexico Gas Company, Inc.; Pacific Gas and Electric Company; PSEG Energy Resources & Trade LLC; Public Service Company of New Mexico; the Public Utilities Commission of the State of California; Salt River Project Agricultural Improvement and Power District; Southern California Edison Company; Southern California Gas Company and San Diego Gas & Electric Company; Southwestern Public Service Company; Southwest Gas Corporation (Southwest); Texas Gas Service Company, a Division of ONEOK, Inc. (Texas Gas Service); and UNS Gas, Inc. and Tucson Electric Power Company.

10. A number of parties filed answers. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2010), prohibits an answer to a protest or to an answer unless otherwise ordered by the decisional authority. We are not persuaded to accept any of the answers and will, therefore, reject them. We note that parties will have a full opportunity to discuss any issues raised by the instant filing during the hearing established herein.

¹⁰ The Indicated Shippers are BP America Production Company and BP Energy Company, ConocoPhillips Company, and Shell Energy North America (US), L.P.

11. Approximately two dozen protests or adverse comments were filed concerning El Paso's proposed rates. All parties appear to agree that El Paso's proposed rate increase, which is alleged to be anywhere from 30 to 50 percent depending on a shipper's rate schedule and rate zone, has not been shown to be just and reasonable and should be suspended for five months and set for an evidentiary hearing. A number of parties assert that El Paso appears to be in a "death spiral" and that the proposed massive rate increase combined with El Paso's request to reduce capacity by permanent or temporary abandonment of compression will not provide El Paso's shippers with the incentive to contract for more capacity, but will likely cause more load loss. El Paso Electric requests a technical conference be convened to discuss possible solutions to this negative spiral issue. The parties also raised concerns with respect to a number of typical rate case issues including, among other things, (1) whether El Paso's \$612 million cost of service is justified; (2) whether a 61/39 percent equity/debt structure with a 12.5 percent return on equity is supported; (3) whether El Paso's proposal to equalize the rates for the California, Nevada and Arizona zones of delivery is justified; (4) whether a west end rate should be added; and (5) whether a 12 percent reduction in billing determinants is factually supported. Parties also protested, among other things, (1) El Paso's proposed methodology for hourly service cost allocation, (2) the production area cost allocation methodology, (3) the alleged excessive level of discounted capacity, (4) the reduced rate for ten-year contracts, and (5) the proposed increased pension costs.

12. Parties additionally raised concerns about a number of El Paso's proposed tariff revisions and request that they also be set for hearing: The protested tariff issues include (1) not including a *force majeure* provision in El Paso's penalty structure, (2) imposing delivery point performance caps which could subject shippers to increased hourly scheduling penalties, (3) modifying the off-system capacity provision, (4) updating the flow path definitions applicable to two contract flow paths, (5) removing the zonal limitations from delivery point flow day diversions, (6) clarifying tariff provisions regarding the aggregation of daily authorized overruns, and (7) updating tariff provisions related to contract assignments.

13. Many of the parties filed protests or comments with respect to the effect of Article 11.2 of the 1996 Settlement on the rates in the instant filing.¹¹ Article 11.2 capped the rates for certain shippers' contracts, subject to an annual escalation factor, and established certain cost recovery limitations for El Paso. Most of the parties argue that the Article 11.2 rate cap remains in effect and that these protections are properly reflected in El Paso's proposed primary tariff records. These parties assert that the alternate and *pro forma* tariff records filed by El Paso are an attempt to terminate or erode that rate cap

¹¹ See *El Paso Natural Gas Co.*, 79 FERC ¶ 61,028, *reh'g denied*, 80 FERC ¶ 61,084.

protection. Certain parties, however, support the acceptance of the alternate tariff records. Nevertheless, most of the parties recognize that a number of issues, including those related to Article 11.2, are pending in Docket No. RP08-426-000 and that an initial decision is due November 19, 2010 in that proceeding. Accordingly, the parties request that El Paso not be permitted to relitigate such issues here and that the tariff records here be made subject to the outcome of the Docket No. RP08-426-000 proceeding.

14. Finally, a number of parties join with Texas Gas Service in arguing that the complaint in Docket No. RP10-951-000 urging mileage-based fuel rates should not be consolidated with this proceeding. El Paso, on the other hand, proposes in the instant filing to maintain its existing postage stamp rate design and reimbursement percentage for fuel cost recovery and suggests that the complaint in Docket No. RP10-951-000 challenging El Paso's postage stamp fuel methodology should be consolidated with the rate case proceeding. While parties on the west end of the system appear content with the current rate design, those parties on the east end of the system generally argue that consolidating the cases would so postpone resolution of the rate design issue, it would effectively deny relief to east end shippers who allege they are overcharged for fuel while subsidizing the fuel costs of west end shippers. These parties assert that, in order to afford relief from El Paso's unjust and unreasonable fuel charges, the Commission should issue a merits decision in that section 5 complaint proceeding before April 1, 2011, the effective date for the rate increase in this general rate proceeding. Parties assert that prompt Commission action in the complaint proceeding would conserve administrative and party resources by providing guidance or by resolving what would otherwise be a contentious and complicated issue in this rate proceeding. In sum, these parties contend that consolidation would delay for years resolution of the discrete fuel issue and effectively deny them needed relief.

Discussion

15. El Paso's filing raises many typical rate case issues that warrant further investigation. The Commission finds that there are material issues of fact in dispute concerning, among other things, the magnitude of the rate increase, what conditions led to such an increase, and whether it is justified. The Commission finds that because of the complexity of the issues raised by the filing, neither summary disposition nor a technical conference is appropriate. Accordingly, the Commission will establish a hearing to explore the issues set forth in the protests, including, but not limited to, those regarding cost-of-service, rate of return, throughput, cost allocation, rate design, and tariff changes. The Commission finds that it is appropriate to examine these issues in the context of a hearing where a factual record can be developed by the parties.

16. El Paso proposed two sets of tariff records, each providing for different treatment of facility cost allocations for contracts pursuant to Article 11.2 of the 1996 Settlement. The primary tariff records include rates for Article 11.2(a) contracts that do not exceed the amount calculated pursuant to Article 11.2(a) of the 1996 Settlement. The alternate

tariff records include rates for Article 11.2(a) contracts that exceed the amount calculated pursuant to Article 11.2(a) to reflect an allocation of costs of certain facilities constructed after 1995 (Expansion Capacity costs). El Paso states that the alternate tariff records are consistent with a Commission order in the 2006 Rate Case in Docket No. RP05-422-000 that provides for the recovery of the Expansion Capacity costs from “all shippers.”¹² However, as Southwest argues in its protest, the Commission rejected similar arguments by El Paso to modify the Article 11.2 rate under the just and reasonable standard in the 2008 Rate Case in Docket No. RP08-426-000.¹³ Therefore, the Commission will accept and suspend the primary tariff records in Appendix A, subject to conditions, and reject the alternate tariff records listed in Appendix B.¹⁴

17. Several of the issues involving the instant filing are pending in other proceedings. The Commission will therefore condition acceptance of the primary tariff records herein on the outcome of the following proceedings: (1) the Texas Gas Service complaint in Docket No. RP10-951-000 regarding whether the current postage stamp fuel rate is just and reasonable; (2) the requests for clarification and/or rehearing in Docket No. RP05-422-000; and (3) the hearing in Docket No. RP08-426-000 regarding capital structure, recovery of certain expansion capacity costs, value-based rates for short term and certain interruptible rates, and certain issues relating to Article 11.2.

18. El Paso must adhere to section 154.303(c)(2) of the Commission’s regulations which provides that at the end of the test period, the pipeline must remove from its rates costs associated with any facility that is not in service or for which certificate authority is required but has not been granted.

Suspension

19. Based on a review of the filing, the Commission finds that the proposed tariff records have not been shown to be just and reasonable, and may be unjust, unreasonable, unduly discriminatory, or otherwise unlawful. Accordingly, consistent with the terms of

¹² El Paso Transmittal Letter at p. 3, (citing *El Paso Natural Gas Co.*, 114 FERC ¶ 61,290 at P 69). We note that the interpretation of that language is pending on rehearing in Docket No. RP05-422-035.

¹³ Southwest Protest at p. 12 (citing *El Paso Natural Gas Co.*, 124 FERC ¶ 61,227 (2008), *on reh’g*, 132 FERC ¶ 61,155 (2010)).

¹⁴ The *pro forma* tariff records which were submitted for informational purposes are effectively a nullity, and were provided to show the rates that El Paso asserts will apply if, as a result of any future Commission or court order, Article 11.2 is terminated or the rates produced by Article 11.2 are found unjust and unreasonable.

the 2008 Rate Case Settlement,¹⁵ the Commission will accept and suspend El Paso's primary tariff records, to be effective April 1, 2011, subject to refund and conditions, the outcome of the hearing procedures ordered herein, and the outcome of certain pending proceedings described above.

20. The Commission's policy regarding suspensions is that tariff filings generally should be suspended for the maximum period permitted by statute where preliminary study leads the Commission to believe that the filing may be unjust, unreasonable, or inconsistent with other statutory standards.¹⁶ It is recognized, however, that shorter suspensions may be warranted in circumstances where suspension for the maximum period may lead to harsh and inequitable results.¹⁷ The Commission finds that, in this circumstance, El Paso proposed the November 1, 2010 effective date assuming a five-month suspension, in order to comply with the 2008 Rate Case Settlement which requires El Paso to file a general rate case for rates effective no earlier than April 1, 2011. Therefore, the Commission will accept and suspend the proposed primary tariff records to be effective April 1, 2011, subject to refund, the conditions of this order, the outcome of a hearing in this proceeding, and the outcome of the proceedings in Docket Nos. RP08-426-000, RP10-951-000, and RP05-422-000, as discussed above.

The Commission orders:

(A) The proposed primary tariff records are accepted and suspended effective April 1, 2011, subject to refund, the outcome of the hearing established in this order, and the outcome of the proceedings in Docket Nos. RP05-422-000, RP08-426-000, and RP10-951-000.

(B) The alternate tariff records are rejected, and the *pro forma* records are moot and of no effect.

(C) Upon its motion to place suspended rates into effect, El Paso must remove facilities not placed in service before the effective date.

(D) Pursuant to the authority of the Natural Gas Act, particularly sections 4, 5, 8, and 15 thereof, and the Commission's rules and regulations, a public hearing shall be

¹⁵ See Paragraphs 13.2 and 13.4 of the 2008 Rate Case Settlement.

¹⁶ See *Great Lakes Gas Transmission Co.*, 12 FERC ¶ 61,293 (1980) (five-month suspension).

¹⁷ See *Valley Gas Transmission, Inc.*, 12 FERC ¶ 61,197 (1980) (one day suspension).

held in Docket No. RP10-1398-000 concerning the lawfulness of El Paso's proposed rates.

(E) A Presiding Administrative Law Judge, to be designated by the Chief Administrative Law Judge for that purpose pursuant to 18 C.F.R. § 375.304, must convene a prehearing conference in this proceeding to be held within 20 days after issuance of this order, in a hearing or conference room of the Federal Energy Regulatory Commission, 888 First Street, NE, Washington, DC 20426. The prehearing conference is for the purpose of clarification of the positions of the participants and establishment by the presiding judge of any procedural dates necessary for the hearing. The presiding administrative law judge is authorized to conduct further proceedings in accordance with this order and the rules of practice and procedure.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.