139 FERC ¶ 61,096
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

El Paso Natural Gas Company Docket No. RP08-426-005

ORDER ON REHEARING

(Issued May 4, 2012)

1. On December 18, 2008, the Commission issued an order (December 18 Order) partially accepting and partially rejecting tariff sheets filed by El Paso Natural Gas Company (El Paso).[1] Requests for clarification and/or rehearing of the December 18 Order were filed in January 2009 by several parties. For the reasons discussed below, the requests for clarification and/or rehearing are granted, in part, and denied, in part. Furthermore, El Paso is directed to file revised tariff records consistent with this order within thirty days of the date this order issues.

I. Background

2. El Paso is a natural gas company that operates an interstate pipeline system for the transportation of natural gas from areas in the southwestern United States through the states of Texas, New Mexico, Colorado, and Arizona, to two points of termination at the boundary between the states of California and Arizona, near Ehrenberg and Topock, Arizona. El Paso also delivers gas to numerous on-system delivery points and off-system eastern markets. El Paso's system consists of the South System and North System mainlines, which can deliver gas from the San Juan, Permian, and Anadarko Basins to various delivery points throughout its system. Its system also includes several "cross-overs" which can deliver gas between the North and South Systems.

3. On June 30, 2005, in Docket No. RP05-422-000, El Paso filed a general system-wide rate case, which modified rates, proposed a number of new services, and revised a number of terms and conditions of service (2006 Rate Case). The 2006 Rate Case was El Paso's first general rate case in ten years. On March 23, 2006, the Commission issued an

[1] *El Paso Natural Gas Co.*, 125 FERC ¶ 61,309 (2008) (December 18 Order).

order addressing a number of discrete issues discussed at a technical conference in this proceeding.[2] Thereafter, on December 6, 2006, El Paso submitted a settlement agreement, which the Commission approved on August 31, 2007 (the 2006 Rate Case Settlement).[3] The rates for service on El Paso's system at the time of El Paso's initial filing in this matter were established by the 2006 Rate Case Settlement, which terminated on December 31, 2008. The 2006 Rate Case Settlement required El Paso to file a new general rate case on June 30, 2008, to be effective on January 1, 2009.

4. The instant proceeding began on June 30, 2008, when El Paso filed revised tariff sheets that proposed a number of changes to its tariff, including new services, a rate increase for existing services, and changes in certain terms and conditions of service.[4] El Paso's Filing included two sets of revised tariff sheets—primary and alternate tariff sheets.[5] On August 5, 2008, the Commission accepted and suspended El Paso's primary tariff sheets, subject to refund, conditions, and the outcome of a hearing and technical conference.[6] The Commission rejected El Paso's alternate tariff sheets.[7] The Commission set for hearing the issues relating to El Paso's proposed cost-of-service, cost allocation, and rate design for existing and new services.[8] The Commission set all other issues related to proposed services, terms, and conditions for technical conference.[9] Several parties sought rehearing of the August 5 Order. On November 10, 2010, the Commission denied those requests for rehearing.[10]

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[2] *El Paso Natural Gas Co.*, 114 FERC ¶ 61,305 (2006).

[3] *El Paso Natural Gas Co.*, 120 FERC ¶ 61,208 (2007).

[4] On July 22, 2008, El Paso filed revised tariff sheets in Docket No. RP08-426-001 to correct a typographical error in its original filing.

[5] The two sets of tariff sheets differed by the manner in which they treated a specific article (Article 11.2) of a 1996 rate settlement.

[6] *El Paso Natural Gas Co.*, 124 FERC ¶ 61,124, at P 28 (2008) (Suspension Order).

[7] *Id.*

[8] *Id.* P 28.

[9] *Id.* P 29.

[10] *El Paso Natural Gas Co.*, 133 FERC ¶ 61,129 (2010).

5. On September 11, 2008, the Commission held a technical conference to address the services, terms, and conditions of service proposed by El Paso. A number of parties filed both initial and reply comments on the matters discussed at the technical conference.

6. In the December 18 Order, the Commission addressed the issues discussed at the technical conference and accepted many of El Paso's proposed tariff revisions, including, but not limited to, proposed revisions to the limited firm hourly virtual area and no-notice services, the tiered penalty structure, the revised critical operating condition penalty rate, the inclusion of the California border spot price in the monthly index, the aggregation of transportation service agreements (TSA) for overrun purposes, the revised definitions of hourly scheduling penalties and safe harbor tolerances, the imposition of the authorized overrun rate for overruns containing quantities from non-telemetered points, changes to strained and critical operating condition (SOC/COC) procedures, and the elimination of seasonal shoulder month flexibility and sculpted maximum daily quantities (MDQ).[11] The Commission rejected some of El Paso's proposed tariff revisions, including El Paso's proposals regarding reservation charge credits, the inclusion of 100 percent of Hourly Entitlement Enhancement Nominations (HEEN) in overrun quantities, and the non-critical penalty rates.[12] In addition, the Commission exercised its authority under section 5 of the Natural Gas Act (NGA) and directed El Paso to change certain tariff provisions concerning HEEN, the elimination of grandfathered pressure commitments, gas quality waivers, and flow control.[13]

II. <u>Requests for rehearing</u>

7. Requests for rehearing of the December 18 Order were filed by the following parties: El Paso;[14] Southwest Gas Corporation (Southwest Gas);[15] Golden Spread

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[11] December 18 Order, 125 FERC ¶ 61,309 at P 6.

[12] *Id.* P 7.

[13] *Id.*

[14] On January 23, 2009, El Paso filed an errata to its rehearing request.

[15] Among other things, Southwest Gas filed a request for rehearing about certain statements made by the Commission regarding El Paso's proposal regarding its right to install flow control equipment. El Paso thereafter withdrew that proposal, and proposed new flow control tariff provisions in other compliance portions of this proceeding (Docket Nos. RP08-426-009, RP08-426-011, and RP08-426-012). Noting that El Paso had withdrawn its proposed tariff provisions, Southwest Gas states that it filed a request for rehearing on this issue as a "protective matter" to ensure that Southwest Gas is not

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Electric Cooperative, Inc. and GS Electric Energy Cooperative (collectively, Golden Spread); Texas Gas Service Company, a division of ONEOK, Inc., and Tucson Electric Power Company, and UNS Gas, Inc. (collectively, Texas Gas); Salt River Project Agricultural Improvement and Power District (Salt River); Electric Generator Coalition[16] (EGC); Indicated Shippers;[17] and Public Service Company of New Mexico (PNM).

8. Subsequently, El Paso and EGC filed answers to the various rehearing requests. Rule 713(d) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.713(d) (2011), prohibits an answer to a rehearing request. We therefore will not accept El Paso's and EGC's answers.

A. Overrun Charges and the Aggregation of Transportation Service Agreements

1. El Paso's Proposal

9. In its June 30 Filing, El Paso proposed a revision to the daily overrun rate applicable to shippers with multiple Transportation Service Agreements (TSA).[18] Pursuant to the 2006 Rate Case Settlement, overrun charges are determined based on the aggregation of all services provided under all of a shipper's contracts on a given day. These overrun charges are billed as a weighted average rate for all the delivery points included in all of the contracts held by a shipper. In its June 30 Filing, El Paso proposed

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prejudiced in a future filing. Southwest Gas, Request for Rehearing at 20-21. Because the Commission addressed Southwest Gas's concerns in the context of El Paso's actual proposed flow control provisions in the compliance portions of this proceeding, there is no need to address them here. *See El Paso Natural Gas Co.*, 129 FERC ¶ 61,036, at P 11, *order on reh'g and compliance*, *El Paso Natural Gas Co.*, 130 FERC ¶ 61,096 (2010). Accordingly, Southwest Gas's rehearing request on this point is moot.

[16] EGC members filing the request for rehearing and clarification include: Arizona Electric Power Cooperative, Inc.; Blythe Energy, LLC; Dynegy Arlington Valley, LLC; Gila River Power, L.P.; Golden Spread Electric Cooperative, Inc. and GS Electric Generating Cooperative, Inc.; New Harquahala Generating Company, LLC; and Sempra Global.

[17] The Indicated Shippers filing the request for clarification and/or rehearing include: ConocoPhillips Company; Shell Energy North America (US), L.P.; and Occidental Energy Marketing, Inc.

[18] December 18 Order, 125 FERC ¶ 61,309 at PP 50-51.

to continue to aggregate TSAs in determining overrun quantities. However, El Paso proposed to revise the daily overrun *rate* applicable to shippers with multiple TSAs under various rate schedules. Rather than using a weighted average rate, El Paso proposed to charge the highest rate for the applicable zone of delivery for both authorized and unauthorized daily overruns.

10. El Paso argued that the averaging of rates caused El Paso to under-collect for the transportation service actually provided shippers.[19] A number of commenters supported the continuation of TSA aggregation but opposed the proposal to charge the highest rate for overruns. El Paso replied that charging the highest rate is the only approach that will prevent shippers from overrunning their contracts at lower rates.[20] El Paso stated that because TSAs are aggregated to determine overruns and because shippers do not nominate unauthorized overruns, El Paso cannot know under what contract unauthorized overrun gas is flowing.

11. El Paso indicated that it was willing to allow shippers a one-time opportunity to opt-out of contract aggregation. Shippers who opt out of contract aggregation would be charged at the rate applicable to the individual contract that was overrun.

2. <u>December 18 Order</u>

12. In the December 18 Order, the Commission accepted El Paso's proposal.[21] The Commission acknowledged the benefits shippers receive from El Paso's aggregation feature. The Commission explained that it understood El Paso's proposal to provide that, in situations where a shipper overruns its contracts, El Paso would charge the highest rate for the zone of delivery for all TSAs under which the shipper received service that day.[22] Elaborating on this provision, the Commission stated that in calculating the overrun penalty, El Paso would only consider the TSAs used by the shipper that day, in the rate zone where the overrun occurred. The Commission further understood El Paso's proposal to mean that if a shipper's overrun occurs in a lower rate zone, the overrun penalty would be determined by the highest rate in that lower rate zone—not by the highest rate in a higher rate zone where the overrun did not occur. The Commission indicated that it believed this interpretation addressed commenters' concerns that El

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[19] *Id.* P 51.

[20] *Id.* P 55.

[21] *Id.* P 56.

[22] *Id.* P 57.

Paso's proposal may charge an overrun penalty for a rate zone different from the zone in which the overrun occurred.[23]

13. The Commission also addressed shippers' arguments that rates for hourly service should not be included in determining an overrun charge because when a shipper overruns a daily contract quantity, it does not necessarily overrun hourly quantities. The Commission found that it is appropriate to include the rates for hourly services in the determination of the overrun charge because hourly services include daily as well as hourly entitlements with corresponding overrun penalties, and hourly service entitlements are included in the aggregation feature.[24] Therefore, the Commission found that it was reasonable to include hourly services in the overrun calculation. Furthermore, the Commission determined that the overrun charge need not be the same for all services, noting that the Commission has previously approved overrun charges based on the underlying rate schedules, which resulted in different levels of overrun charges for different services.[25]

14. Finally, the Commission noted El Paso's willingness to offer a one-time opportunity for shippers to opt out of the aggregation feature. Thus, shippers who would prefer to have their overrun penalties calculated on a contract-specific basis would be able to choose that option.[26]

3. Requests for Rehearing

15. El Paso, Southwest Gas, EGC, Indicated Shippers, and Texas Gas filed requests for rehearing of the Commission's decision regarding the Commission's acceptance of El Paso's proposal to revise the daily overrun rate applicable to shippers with multiple TSAs.

16. In its rehearing request, El Paso states that although the Commission accepted its proposal to charge the highest overrun rate in connection with the aggregation of TSAs,

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[23] *Id.*

[24] *Id.* P 58.

[25] *Id.* (citing El Paso FERC Gas Tariff, Second Revised Sheet No. 28D (stating that the Daily Authorized Overrun rate for Rate Schedule FT-H is "not more than Maximum Daily FT-H 100% Load Factor Rate and not less than Minimum Daily FT-H Usage Rate," and the Daily Unauthorized Overrun charge for quantities equal to or less than the safe harbor tolerance quantities is also the Daily Authorized Overrun Rate)).

[26] *Id.* P 59.

the Commission may have erred in its interpretation of El Paso's proposal.[27] El Paso emphasizes that due to the aggregation feature established in the 2006 Rate Case Settlement, it is not generally possible to attribute unauthorized daily overruns to specific contracts within a shipper's portfolio. El Paso argues that charging a weighted average rate for these overrun quantities has led to shippers paying a lower rate than justified for the service they received. El Paso explains that this is why it proposed to charge the highest rate under all zones of delivery under all rate schedules for which service was provided on a particular day.[28]

17. El Paso expresses concern that although the Commission accepted its proposal, statements in the December 18 Order may be inconsistent with the proposed tariff provisions and could lead to uncertainty or controversy. El Paso cites the following language from the December 18 Order: "[I]f a shipper's overrun occurs in a lower rate zone, the overrun penalty will be determined by the highest rate in that lower rate zone, and not by the highest rate in the higher rate zone where the overrun did not occur."[29] El Paso explains, however, that its proposal is to charge the highest rate of *all zones* in which gas was delivered on a particular day, not the rate in the zone where the overrun occurred.[30] El Paso again emphasizes that because of the aggregation feature, it does not know which contract in which zone was overrun. Accordingly, El Paso seeks clarification that the Commission has accepted its proposal to charge an overrun rate equal to the highest rate in the zones where service was provided that day.[31] Should the Commission not grant clarification of this point, El Paso seeks rehearing.

18. In its rehearing request, Texas Gas argues that El Paso's overrun charge proposal is unjust and unreasonable because it would assess charges for overruns at a rate that has no relationship to the service provided and in some cases, at a rate based on a service that El Paso has stated that it cannot provide in a particular area.[32] Texas Gas also highlights

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[27] El Paso, Request for Rehearing at 24-27.

[28] *Id.* at 25.

[29] *Id.* (quoting December 18 Order, 125 FERC ¶ 61,309 at P 57).

[30] El Paso clarifies that where service is not provided in a given rate zone on a particular day, the rate for that zone will not be used even though it may be the highest of all of the shipper's TSAs.

[31] El Paso, Request for Rehearing at 26-27.

[32] Texas Gas, Request for Rehearing at 3-4 (explaining that any of Texas Gas's overruns in the Permian Basin Virtual Area would be assessed at a much higher Texas

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the issue raised by El Paso on rehearing—uncertainty over language in the December 18 Order interpreting El Paso's proposal as basing the overrun charge on the highest rate for contracts in the zone where the overrun occurred. Texas Gas points out that the Commission's interpretation of El Paso's proposal is at odds with El Paso's interpretation, which (as El Paso explains in its rehearing request) would base the overrun charge on the highest rate for all contracts in any zone used by the shipper that day.[33] Texas Gas argues that this internal inconsistency in the December 18 Order results in a failure of the Commission to respond meaningfully to its concerns about El Paso's proposal. Texas Gas also states that given the Commission's finding that El Paso would not charge an overrun penalty for a rate zone different from the zone in which the overrun occurred, the Commission should have rejected El Paso's proposal outright.[34]

19. Southwest Gas concurs, arguing that "zonal aggregation" (i.e., the December 18 Order's interpretation of El Paso's proposal) will provide greater shipper flexibility and is both feasible and necessary to achieve a just and reasonable result.[35] Southwest Gas also argues that zonal aggregation of contracts addresses El Paso's concern that it is currently under-recovering costs where shippers with multiple contracts incur overruns in higher rate zones while paying the lower weighted average rate for such overruns.[36]

20. Indicated Shippers also point to the inconsistency between El Paso's proposal to use the highest rate for all contracts under which the shipper received service on a given day and the Commission's interpretation that would limit El Paso's proposal to the highest rate for all contracts in the zone in which the overrun took place.[37] Indicated Shippers contend that the Commission's interpretation is the correct one. However, Indicated Shippers contend that given the difference between El Paso's proposal and the Commission's interpretation, the Commission should have rejected the proposal instead of accepting it. Indicated Shippers also argue that El Paso's pre-existing weighted average method is a more equitable way to determine the overrun rate. They explain that

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FTH-8 rate, even though El Paso asserts it cannot provide FTH-8 service in the Permian Basin Virtual Area).

[33] *Id.* at 4-6.

[34] *Id.* at 8.

[35] Southwest Gas, Request for Rehearing at 16.

[36] *Id.* at 17.

[37] Indicated Shippers, Request for Rehearing at 4.

El Paso cannot determine where an overrun occurred, and it is therefore just as likely that the overrun would have been under a lower-cost contract as it is that the overrun would be under a higher-cost contract.[38]

21. In order to address El Paso's concerns that it may be providing service in downstream zones at upstream rates, Texas Gas recommends an alternative proposal that would revise the current weighting of all contracts. Texas Gas suggests that El Paso assess overrun charges in each delivery zone using the weighted average of all rates for services taken in the delivery zone.[39] Texas Gas disputes El Paso's contention that it cannot attribute an overrun to a specific zone, noting that El Paso knows where it provides service, what contracts shippers have, where the primary delivery points are, and where a shipper schedules to alternate zones.[40]

22. Additionally, Southwest Gas contends that none of the justifications given by the Commission support a conclusion that El Paso's proposed overrun charge is just and reasonable.[41] Southwest Gas argues that the Commission's statement "that it is appropriate to include the rates for hourly services in the determination of the overrun penalty" does not provide a rational basis for approving an overrun calculation method that uses only the highest rate. Southwest Gas points out that regardless of whether hourly rates are included, El Paso would, by definition, over-recover revenues over time under its highest rate proposal.[42] Southwest Gas also argues that any benefit to shippers from aggregating contracts to determine overruns will not offset the revenue over-recovery that would result from El Paso's proposal.

23. Southwest Gas also disputes the relevance of El Paso's argument that its tariff requires it to waive unauthorized overrun charges when a shipper incurs a higher penalty

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[38] *Id.* at 6.

[39] Texas Gas, Request for Rehearing at 7.

[40] To illustrate its point, Texas Gas appends analyses of eight hypothetical overrun scenarios that were set forth in its earlier comments. Texas Gas argues that the Commission failed to address the concerns raised by these analyses. Texas Gas asserts that these analyses demonstrate how El Paso's proposal would result in unjust and unreasonable overrun charges. *Id.* at 8.

[41] Southwest Gas, Request for Rehearing at 15.

[42] *Id.* (noting that the inclusion of hourly service rates is not inconsistent with El Paso's pre-existing method of using a weighted average rate).

on that day. Southwest Gas notes that Commission policy that multiple penalties should not apply to the same action undercuts this argument in favor of El Paso's proposal.[43]

24. Southwest Gas also argues that shippers' ability to opt out of the aggregation method does not justify the use of the highest rate. Southwest Gas notes that under the contract-specific method for imposing overrun charges, point operators without Operational Balancing Agreements (OBA) would be saddled with greater overrun exposure based on the actions of other shippers.[44]

25. In its request for rehearing, EGC urges the Commission to clarify that its approval of El Paso's "one-time opportunity" to opt out of the contract aggregation methodology does not mean to preclude El Paso from revisiting the contract aggregation methodology and reviewing whether it will grant shippers more than a one-time opportunity to opt out of or back into the aggregation methodology.[45]

4. Commission Determination

26. Upon further consideration of El Paso's proposed overrun charge provision, and in light of El Paso's and other parties' characterization of the proposal in requests for clarification/rehearing, we grant rehearing of the December 18 Order and reject the proposed tariff provision.

27. As the Commission recognized in the December 18 Order, nothing in this proceeding changes the way in which El Paso allows shippers to elect to have their daily overruns calculated on an aggregate basis.[46] Instead of being calculated on a contract-by-contract basis, shippers may elect to have daily overruns calculated in the aggregate, by taking the difference between the sum of all total contract demands (TCD) in a shipper's TSAs and the sum of all quantities actually transported on all of a shipper's TSAs for that day.

28. What El Paso did propose in this proceeding is to change the way in which the daily overrun *rate* is calculated. Prior to this proceeding, El Paso billed daily overruns at

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[43] *Id.* at 18.

[44] *Id.* at 17 (acknowledging that costs could be allocated by the point operator to third-party shippers, but noting that these costs would still be unreasonably inflated by El Paso's proposal).

[45] EGC, Request for Rehearing at 6-7.

[46] December 18 Order, 125 FERC ¶ 61,309 at PP 56-57.

the weighted average rate for all delivery points included in all contracts held by the shipper and considered in the aggregated overrun computations.[47] In this proceeding, "El Paso proposed to change from the use of a weighted average rate under all of the shipper's contracts to the use of the highest contract rate for the applicable zone or service for which the transportation actually occurred."[48]

29. As discussed above, the Commission accepted El Paso's proposed change to the overrun rate calculation, but emphasized that it did so with the following understanding:

> [F]or the calculation of the overrun penalty, El Paso will only use the TSAs used by the shipper that day, in the rate zone for which the overrun occurred. El Paso will not use the highest rate under all rate zones for all TSAs, regardless of delivery. Thus, if a shipper's overrun occurs in a lower rate zone, the overrun penalty will be determined by the highest rate in that lower rate zone, and not by the highest rate in the higher rate zone where the overrun did not occur.[49]

The Commission highlighted the importance of this understanding, noting that its interpretation of the provision addressed commenters' concern about El Paso charging an overrun penalty for a rate zone different from the zone in which the overrun occurred.[50]

30. On rehearing, the Commission is informed by both El Paso, as well as a number of its shippers, that its understanding of El Paso's proposal, as explained in the December 18 Order, was in error. El Paso explains that its proposal is to charge the highest rate of all zones in which gas was delivered on a particular day, not the rate in the zone where the overrun occurred.[51] Accordingly, El Paso seeks clarification, or in the alternative rehearing, that the Commission's acceptance of its proposal is consistent with this understanding. On the other hand, shippers argue that the December 18 Order's description of El Paso's proposal is correct, i.e., that El Paso would not charge an overrun penalty for a rate zone different from the zone in which the overrun occurred. However,

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[47] El Paso, Request for Rehearing at 24-25.

[48] El Paso, Initial Comments on Technical Conference at 7.

[49] December 18 Order, 125 FERC ¶ 61,309 at P 57.

[50] *Id.*

[51] El Paso, Request for Rehearing at 25.

shippers contend that given this understanding, the Commission should have rejected El Paso's proposal.

31. Accordingly, the issue for the Commission to resolve on rehearing is whether it should have accepted El Paso's proposed revision to the overrun charge given the consensus between El Paso and its shippers that the Commission misinterpreted the nature of the provision in the December 18 Order. As discussed below, the Commission's understanding that El Paso's proposal would have based the aggregate overrun rate on the highest rate *in the zone where the overrun occurred* was critical to the decision in the December 18 Order. Accordingly, we find that because this interpretation was in error, and El Paso in fact seeks to base the aggregate overrun rate on the highest rate *of all zones in which gas was delivered on a particular day*, the Commission erred in accepting El Paso's proposal. Therefore, we grant rehearing and reject the proposed tariff revision here.

32. Because the overrun rate is intended to compensate El Paso for the overrun service provided,[52] as opposed to a penalty designed to deter shipper behavior,[53] the Commission must examine whether the rate reflects the cost of providing the overrun service to determine whether it is just, reasonable, and not unduly discriminatory. At the time of the December 18 Order, the Commission indicated that by limiting the scope of the contracts considered in determining the "highest of" rate to those contracts utilized in the zone where the overrun occurred, El Paso had met its burden to make such a demonstration. The December 18 Order can be read to mean that where a net overrun occurs in a particular zone, it was reasonable for El Paso to change the rate from a weighted average of all contracts to the highest contract rate for service in that zone. In this way, El Paso would continue to reasonably impute a value the overrun service provided.

33. However, without the geographic limitation understood by the Commission, the number of contracts used to derive the "highest of" rate expands to include contracts in other zones with significant price differentials. The effect of this expanded pool of contract rates from which to elicit the "highest of" is to guarantee that El Paso will over-

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[52] El Paso, June 30, 2008 Transmittal Letter at 15 ("This change to the overrun rates appropriately values the transportation service provided.").

[53] *Algonquin Gas Transmission, LLC*, 115 FERC ¶ 61,067, at P 16 (2006) ("Penalty charges are not cost-based, and their essential purpose is to deter undesirable shipper behavior") (citing *Northern Natural Gas Co.*, 77 FERC ¶ 61,282, at 62,235-37 (1996), *reh'g denied*, 78 FERC ¶ 61,355, at 62,494 (1997); *Trunkline Gas Co.*, Opinion No. 441, 90 FERC ¶ 61,017, at 61,078 (2000)).

recover the costs of providing the relevant overrun service by assuming, in every instance, that overruns are attributed only to the highest cost contract under which gas is transported for a shipper on the relevant day.

34. El Paso has made no showing that this "highest of" rate bears any relation to the cost of the service actually provided, and instead relies on the unsupported assumption that the highest cost contract is the one overrun. In fact, El Paso repeatedly states that it cannot determine which contract was overrun.[54] Thus, where El Paso cannot determine which contract was overrun, though apparently can tell where the overrun occurred, it is not reasonable to permit El Paso to over-recover its costs by charging the "highest of" contract rate among contracts across all zones.

35. Because we accepted El Paso's proposal in the December 18 Order, and therefore did not expressly address comments in support made by El Paso following the technical conference, we will address those comments here. El Paso contended that the use of a weighted average rate in the calculation of overruns could lead to inequitable results by allowing shippers to overrun their contract demands under higher-priced services and/or rate zones and pay only the lower weighted average rate.[55] Were El Paso able to determine which contracts were overrun in a particular instance, this argument might be persuasive. However, given that El Paso repeatedly states that it cannot determine which contract is overrun, it is just as likely that a lower cost contract was the one that was overrun as it is that a higher cost contract was overrun. Accordingly, this argument does not support El Paso's "highest of" overrun rate.

36. El Paso also argued that its weighted average rate resulted in a cross-subsidization among shippers to the detriment of single contract shippers, who do not receive the benefit of contract aggregation.[56] Again, El Paso's assertion that its existing mechanism results in cross-subsidization is premised on the notion that its proposed "highest of" rate is somehow a more accurate representation than the weighted average rate for the cost of the overrun service provided to shippers who aggregate contracts for overrun purposes.

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[54] El Paso, Initial Comments on Technical Conference at 7 ("[I]t is impossible to attribute the overrun to a specific contract due to the aggregation feature."). El Paso, Request for Rehearing at 25-26 ("[T]he rationale for this proposal is that due to the aggregation feature and the fact that the shipper is effectively given the benefit of scheduling to alternate locations whether it did or not, El Paso does not know which contract was overrun.").

[55] El Paso, Initial Comments on Technical Conference at 7.

[56] *Id.*

However, as discussed above, the Commission finds that it is not. El Paso's proposal to impute the highest rate to aggregated overruns does little to solve any cross-subsidization problem, and instead simply guarantees that El Paso will over-recover the cost of providing overrun service.

37. El Paso even acknowledged that its "highest of" rate proposal could lead to shippers over-paying for overrun service; however, it contended that its proposal was nonetheless just and reasonable because 1) it is not required to offer contract aggregation and by doing so, shippers received a significant benefit in terms of being able to limit exposure to overrun charges, and 2) because shippers control their takes from the pipeline, an assumption should be made that the shipper used the highest priced, most flexible service.[57]

38. First, simply because a pipeline's tariff includes a mechanism—in this case the aggregation feature—that is not generally required of all pipelines and that provides certain benefits to shippers, it does not follow that the mere existence of that tariff feature grants the pipeline license to implement that feature in a way that is not just and reasonable. Nor does it follow that the choice for shippers to opt-out of the contract aggregation feature somehow permits El Paso to charge its proposed "highest of" rate.[58] Even where El Paso provides shippers with the benefit of contract aggregation, it is not permitted to charge a rate for remaining overruns that would guarantee that El Paso over-recovers its costs should shippers choose to avail themselves of the benefit. Second, we do not agree with El Paso's argument that its proposal to over-recover costs is supported by the fact that shippers control their takes from the pipeline. Again, because El Paso cannot identify which contract was overrun, it is unreasonable to assume that in every case, the shipper has overrun the highest price contract.

39. For these reasons, we grant rehearing of the December 18 Order and reject El Paso's proposal to use the "highest of" overrun rate. El Paso must file revised tariff sheets reinstating the weighted average overrun rate in effect prior to this proceeding within 30 days of the date of this order.

40. Finally, with respect to EGC's concerns that the December 18 Order might preclude El Paso from giving shippers more than a one-time opportunity to opt out of or back into the aggregation methodology, we clarify that the December 18 Order was not meant to place any such limitation on El Paso.

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[57] *Id.* at 9-10.

[58] *See* El Paso, Reply Comments on Technical Conference at 8-9.

B. Inclusion of Hourly Entitlement Enhancement Nominations (HEEN) in Overrun Quantities

1. El Paso's Proposal

41. HEEN is an enhanced scheduling right under El Paso's Rate Schedules FT-1, FT-H, NNTD, and NNTH, that increases service flexibility by allowing for non-uniform hourly flows of gas. Specifically, HEEN permits a shipper to designate some portion of its daily entitlement to be used to support expected non-uniform rates of flow during the gas day. This tariff feature allows shippers to nominate peak hour requirements separately through the use of a HEEN. However, the sum of HEENs and flowing gas nominations may not exceed, on a primary firm basis in any one hour, the peak hourly entitlement under the shipper's MDQ. If it does, El Paso considers this to be a daily unauthorized overrun. These daily unauthorized overruns are calculated by adding together the shipper's flowing gas scheduled quantities and HEEN scheduled quantities and comparing that total to the shipper's contract demand.

42. During the 2006 Rate Case Settlement negotiations, El Paso recognized that its customers needed time to change to its new services and penalty structures. El Paso explained that as a result, the 2006 Rate Case Settlement provides that until December 31, 2008, only 50 percent of the HEEN scheduled quantities would be used in determining daily unauthorized overruns.

43. In this proceeding, El Paso recognized that its shippers may still need time to complete the transition to the new service and penalty structure, and therefore proposed a gradual increase for the 2009 calendar year. El Paso proposed to apply only 75 percent of HEEN scheduled quantities to the calculation of daily unauthorized overruns, rather than 100 percent. As of January 1, 2010, El Paso proposed to include 100 percent of HEEN scheduled quantities in the calculation of daily unauthorized overruns.

44. Most shippers objected to El Paso's proposal to increase the amount of HEEN included in the overrun calculation. Commenters made numerous arguments in the proceeding below that El Paso's proposal would limit shipper flexibility, increase their exposure to penalties, and overcharge them for the services provided.[59] Commenters also disputed El Paso's contention that the use of 50 percent HEEN volumes in unauthorized overrun calculations was meant to be transitional.[60]

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[59] December 18 Order, 125 FERC ¶ 61,309 at PP 69-73.

[60] *Id.* P 79-80.

2. December 18 Order

45. In the December 18 Order, the Commission rejected El Paso's proposal to include HEENs in the overrun calculation phased in over two years.[61] The Commission found that El Paso's proposal would limit shippers' use of HEEN and increase their penalty exposure.[62] The Commission found that El Paso's proposal would impose a daily overrun charge that could apply when a shipper's flowing gas is in excess of scheduled quantities for some hours of the day, but still within contractual limits for the day. Because the shipper's daily flow remained within its contract demand, the Commission viewed these variances as scheduling variances that may be subjected to scheduling penalties, not as overruns.[63] The Commission explained that HEENs are not the same as flowing gas—instead a HEEN reserves capacity to be used for flowing gas later in the day and thus should not be included in the daily overrun calculation. The Commission further explained that while HEEN reserves capacity within the shipper's MDQ for the shipper to use as flowing gas later in the gas day, the reservation, in and of itself, is not equivalent to flowing gas.

46. The Commission found that El Paso's proposal to include 100 percent of HEEN in the overrun calculation would be inconsistent with Commission policy rejecting daily scheduling penalties. The Commission explained how El Paso's proposal to include 100 percent of a shipper's HEENs in addition to its actual flows could result in the shipper exceeding its contract demand for the purposes of the overrun calculation while in reality, the shipper's daily take would remain below its total contract demand.[64]

47. The Commission found that El Paso's proposal to include 100 percent of HEENs in the overrun calculation would essentially be the same as implementing the daily scheduling penalty previously proposed by El Paso and rejected by the Commission because it would place shippers in a position where it would be extremely difficult to

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[61] December 18 Order, 125 FERC ¶ 61,309 at P 92. El Paso's proposal would have increased the amount of HEEN included in the overrun calculation to 75 percent for 2009 and 100 percent thereafter. As in the December 18 Order, the Commission will refer to El Paso's entire proposal as its proposal to include 100 percent of HEEN nominations in the overrun calculation. *Id.*

[62] *Id.* P 93.

[63] *Id.* (explaining that overruns are quantities of gas taken in excess of a shipper's contract demand).

[64] *Id.* P 94.

avoid some kind of penalty.[65] Thus, when considered in combination with the existing penalties and service structure in place on El Paso's system, the Commission found El Paso's new HEEN proposal to be unjust and unreasonable.[66]

48. The Commission then found that it would be inappropriate to include any HEEN quantities in the calculation of daily overrun charges.[67] The Commission acknowledged that it approved El Paso's largely uncontested 2006 Rate Case Settlement with a form of this daily penalty structure (the provision was effectively nullified by calculating penalties on just 50 percent of HEEN quantities), but it also explained that it made no merits determination on the appropriateness of the specific provision. The Commission explained that a shipper should not be subject to a daily overrun penalty unless its flowing gas exceeds its total contract demand. Accordingly, the Commission rejected El Paso's proposal to use 100 percent of HEENs in the calculation of daily overrun penalties and directed El Paso to revise its tariff provisions accordingly.[68]

3. Request for Rehearing

49. In its request for rehearing, El Paso states that its tariff's HEEN feature was implemented as a tool to ease the transition to hourly services, to recognize that gas is scheduled in daily quantities in multiple scheduling cycles throughout the gas day, and to minimize the incurrence of scheduling penalties.[69] El Paso states that once a HEEN is scheduled, the pipeline uses "storage" space (effectively, linepack gas) in the pipeline equal to the HEEN for that shipper to create the capacity needed for later use. El Paso states that it cannot then use or schedule that same capacity for other purposes.[70]

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[65] El Paso proposed a daily scheduling penalty in the 2006 Rate Case proceeding and in Docket No. RP07-511-000. In both cases, the Commission rejected the penalty. *See El Paso Natural Gas Co.*, 114 FERC ¶ 61,305, at P 118 (2006); *El Paso Natural Gas Co.*, 121 FERC ¶ 61,265, at PP 27-30 (2007).

[66] December 18 Order, 125 FERC ¶ 61,309 at P 95.

[67] *Id.* P 96.

[68] *Id.* The Commission made additional findings about El Paso's HEEN proposal in response to specific comments made in the proceeding below that are not challenged here. *Id.* PP 97-99.

[69] El Paso, Request for Rehearing at 3.

[70] *Id.* at 4.

50. El Paso analogizes the daily capacity used for HEEN to accommodate shippers' subsequent peak hour requirements to capacity release: as a releasing shipper cannot use capacity it released, once HEEN is scheduled, the "releasing" HEEN shipper is informing the acquiring party (El Paso) that it will not use that reserved or released capacity for its normal throughput needs, and that El Paso should instead use the space to prepare for the shipper's hourly delivery requirements.[71] El Paso contends that because the "releasing" HEEN shipper has already relinquished the capacity for HEEN purposes (use in peak hours of the day), that capacity is no longer available for use by the HEEN or other shippers. El Paso states that just as a capacity releasing shipper would be charged for overruns if it *and* the replacement shipper used the released capacity, so too must the "releasing" HEEN shipper be charged for overruns if its use of capacity to flow gas and to use the necessary "storage" space exceeds its contractual entitlement.

51. El Paso states that because a HEEN is a shipper's request to use daily pipeline capacity (and shippers do not pay an additional charge to use HEEN), El Paso proposed to include scheduled HEEN quantities in the calculation of daily overrun charges.[72] El Paso asserts that the Commission accepted, over protest, its 2005 proposal to include 100 percent of scheduled HEEN quantities in the calculation of daily overrun charges.[73] El Paso states that notwithstanding the Commission's acceptance of its 2005 HEEN proposal, El Paso agreed in the 2006 Settlement to a compromise transition measure, whereby it would charge only 50 percent of scheduled HEEN quantities in the daily overrun calculation for a three-year term.

52. El Paso states that its proposal in this proceeding would transition to the full inclusion of HEEN quantities into the daily overrun calculation by including 75 percent in 2009 and 100 percent thereafter.[74] El Paso contends that the Commission's rejection of El Paso's proposal, as well as its finding that El Paso's current inclusion of 50 percent HEEN in the daily overrun charge is unjust and unreasonable, are neither rational nor sufficiently explained. El Paso also contends that the Commission departed from its earlier acceptance of the HEEN/overrun tariff sheet in an earlier order without explanation.[75]

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[71] *Id.*

[72] *Id.* at 5 & n.2.

[73] *Id.* at 5 (referencing *El Paso*, 114 FERC ¶ 61,305).

[74] *Id.*

[75] *Id.* at 6 (citing *El Paso*, 114 FERC ¶ 61,305).

53. El Paso emphasizes that the inclusion of HEEN quantities in the calculation of the daily overrun charge is based on the fact that such quantities represent a daily use of the system. El Paso asserts that physical capacity is used to retain linepack to satisfy a HEEN over the course of the day, and that the capacity that is packed for these purposes cannot be scheduled for firm alternate or interruptible service during that day.[76] El Paso contends that the use of this physical capacity to maintain linepack to provide non-uniform service throughout the day is in substance no different than a shipper's use of capacity to flow gas, as such capacity cannot be used for another purpose and imposes costs on El Paso's system. El Paso argues that this point is undisputed and also cites an earlier Commission order acknowledging as much.[77] El Paso argues that the December 18 Order fails to acknowledge this fact or explain why this use of capacity should not be considered in determining whether a shipper has exceeded its daily capacity entitlement.

54. El Paso contends that the findings made by the Commission in the December 18 Order are irrelevant and do not support the elimination of HEEN in the daily overrun calculation. El Paso objects to the Commission's finding that because a HEEN is not flowing gas, it should not be included in the calculation of daily overruns. El Paso asserts that the problem with this argument is that the Commission has never had reason to address whether a physical use of daily capacity for non-uniform deliveries during the gas day should be included in the overrun calculation because the issue only arises from the fact that El Paso has implemented hourly services, including HEEN.[78] Accordingly, El Paso contends that the fact that the Commission may have previously considered only flowing gas in the daily overrun calculation (in the absence of hourly service) is not germane to the question presented here: should a reservation of capacity for use in the gas day, in connection with hourly services, be included in the daily overrun calculation?[79]

55. El Paso contends that the answer to this question must be "yes" because with a HEEN, a shipper has nominated a "storage" capacity quantity in addition to its flowing

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[76] *Id.* at 7.

[77] *Id.* (quoting *El Paso*, 114 FERC ¶ 61,305 at P 70 (recognizing that "HEEN is a nomination made by the shipper that designates some portion of its otherwise available daily entitlement to be used to support expected non-uniform rates of flow during the gas day")).

[78] *Id.* at 7-8.

[79] *Id.* at 8.

gas quantity, and this "storage" capacity physically uses an amount of daily capacity to allow non-uniform deliveries. Therefore, El Paso argues, a shipper that flows gas, such that when added to HEEN amounts the total exceeds its contract rights, is using capacity in two ways without paying for the use of physical capacity to provide the non-uniform flow of gas.[80]

56. Moreover, El Paso argues that the Commission's findings that HEEN quantities are really scheduling variances (and that the Commission has already rejected daily scheduling penalties) are based on the same flawed assumption that only flowing gas can be included in the daily overrun calculation.[81] El Paso also argues that the Commission relies on a flawed rationale that allowing inclusion of HEEN quantities in the daily overrun calculation will have the same effect as a previously proposed daily scheduling penalty that the Commission rejected. El Paso contends that this argument (and the example used by the Commission in the December 18 Order) shows nothing more than the fact that an excess take of flowing gas that causes a scheduling variance *may* also cause an overrun if it causes the shipper to exceed its contract demand (flowing gas plus HEEN). However, El Paso states that its proposal does not compare HEEN and/or flowing gas to scheduled quantities; instead, it seeks to recognize the use of capacity that a HEEN entails in determining whether such use, when coupled with flowing gas use, has exceeded a shipper's contracted daily capacity entitlement. El Paso, therefore, believes the Commission confuses scheduling variances and overruns in reaching its conclusion in the December 18 Order. El Paso contends that there is nothing inappropriate about imposing separate penalties for hourly scheduling variances and daily overruns as shippers should be required to take gas within both daily and hourly limits or incur penalties.[82]

57. El Paso also argues that the Commission's faulting of El Paso for not explaining why it is appropriate to apply a daily penalty to violations of an hourly service illustrates a fundamental misunderstanding of El Paso's proposal. El Paso does not contend that a shipper's use of HEEN results in a violation of its hourly service; rather, HEEN facilitates hourly service by giving a shipper a nomination that uses daily pipeline capacity to vary its hourly takes within daily limits without being exposed to hourly scheduling penalties. El Paso emphasizes, however, that the issue here is whether a

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[80] *Id.* at 8-9.

[81] *Id.* at 9.

[82] *Id.* at 12 (noting that El Paso's tariff provides that a shipper who incurs an hourly scheduling penalty and a daily unauthorized overrun charge would pay the higher of the two, but not both).

shipper's use of HEEN in combination with its flowing gas exceeds its *daily* contract entitlement. El Paso explains that while HEEN is intended to facilitate a shipper's hourly services, a shipper must limit its flowing gas and use of HEEN to its daily entitlement or be subject to a daily overrun penalty.[83] El Paso states that it never intended this hourly flexibility to allow a shipper to use more daily capacity (including the daily reserved "storage" capacity) than it contracted for without being subjected to an unauthorized daily overrun penalty. El Paso states that if the Commission does not grant rehearing of the December 18 Order on this point, shippers will be allowed to utilize HEEN to avoid hourly penalties (which was intended), but also to incur daily imbalances without penalty (which was not intended).

4. Commission Determination

58. We deny El Paso's request for rehearing on this point. El Paso's central argument on rehearing is that in rejecting El Paso's proposal to include 100 percent of HEEN volumes in the daily overrun charge, the December 18 Order failed to address El Paso's contention that a HEEN is physical use of capacity in much the same way that flowing gas is a physical use of capacity. El Paso contends that in light of the similarities between HEENs and flowing gas, both should be considered in the daily overrun calculation. We disagree.

59. El Paso makes the case that because a HEEN requires the pipeline to pack its system in preparation for non-uniform hourly flows that will occur later in the day (affecting portions of the pipeline within 300-400 miles of the delivery point), the HEEN represents a physical use of capacity such that El Paso cannot use that capacity for some other purpose. We agree that the HEEN makes some use of physical capacity. However, we disagree with El Paso's determination that this justifies factoring HEENs into the daily overrun calculation in the same way that flowing gas is factored into the calculation. Simply put, a HEEN is not the same as flowing gas for the purposes of the overrun calculation. To explain, we will use the same hypothetical set forth in the December 18 Order.

60. The December 18 Order provided an example where a shipper with a total contract demand of 10,000 Dth/d schedules 5,000 Dth of flowing gas and a HEEN of 5,000 Dth.[84] If the shipper exceeds its scheduled quantities by 1,000 Dth in any given hour, it would incur a daily overrun penalty according to El Paso's proposal. This would occur because El Paso would add the shipper's actual flows (6,000 Dth) to the HEEN nomination

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[83] *Id.* at 13.

[84] December 18 Order, 125 FERC ¶ 61,309 at P 96.

(5,000 Dth) for a total of 11,000 Dth, which is 1,000 Dth more than the shipper's total contract demand. El Paso would charge the shipper a daily overrun penalty even though the shipper's actual takes (6,000 Dth) were less than the shipper's total contract demand (10,000 Dth).

61. We affirm our conclusion that in this situation, the shipper should not face an overrun charge because its actual takes remain below its total contract demand. Because the shipper has a 5,000 Dth HEEN in place, the pipeline should have the capacity to accommodate the shipper's additional 1,000 Dth that the shipper flowed in a given hour without causing operational problems for El Paso. Where El Paso physically uses 5,000 Dth (HEEN) of capacity to reserve space for a shipper's non-uniform flows, it does not follow that an unscheduled flow of 1,000 Dth in a particular hour somehow utilizes more than the reserved capacity such that it merits the imposition of an overrun penalty—especially absent some operational harm being suffered by the pipeline. Rather, because the amount of gas flowed on El Paso's system in this example remains within the shipper's contract demand, the shipper should not be subject to an overrun penalty.

62. El Paso argues that HEENs can be analogized to a capacity release. We disagree. With a capacity release, a shipper relinquishes control of the capacity in return for payment. With HEEN, the shipper does not relinquish control of that capacity, does not receive payment, and instead expressly informs El Paso that it intends to use such capacity at some point later in the gas day. El Paso utilizes its linepack to provide this flexibility, not unlike how all pipelines use linepack to manage deliveries and imbalances in the ordinary course of business. Accordingly, we view HEENs as analogous to the use of linepack to manage variations in daily pipeline use. Moreover, because the shipper retains the right to use the HEEN capacity, we do not see how it can be compared to capacity that is affirmatively sold to another shipper for another discrete use. We therefore find the analogy between HEEN and capacity release to be inapt.

63. The Commission has previously found that HEEN is a tariff feature that is intended to provide shippers with the flexibility to take advantage of El Paso's hourly services.[85] Were El Paso permitted to include HEEN amounts in the determination of overrun penalties, the flexibility afforded shippers by the HEEN feature would be significantly undermined. Whereas the Commission accepted the HEEN proposal, in part, to better help shippers manage and utilize their firm capacity so as to avoid penalties, the inclusion of HEEN amounts in calculating overruns would subject shippers to additional penalties, even where they do not exceed their daily contractual entitlements.

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[85] *El Paso*, 114 FERC ¶ 61,305 at P 78.

64. By no means does this finding prevent El Paso from penalizing a shipper who violates its tariff. When the shipper in the example above takes 1,000 Dth more than it scheduled, it would not be subject to an overrun charge, but it would be subject to an hourly scheduling penalty, just as it would if it took more gas than scheduled on a day that it did not avail itself of HEEN. The hourly scheduling penalty would thus work as an incentive for shippers to schedule HEEN and flowing gas within the tariff limits.

65. Moreover, it is important to emphasize that the Commission evaluates El Paso's overrun penalty mechanism in the context of El Paso's unique penalty structures. The Commission has recently explained that it has only approved hourly scheduling penalties in a limited number of instances, of which El Paso is one.[86] Further, in discussing such hourly scheduling penalties, the Commission explained that "[r]estrictions on hourly takes and penalties for violating such hourly restrictions are significantly more burdensome on shippers than a daily scheduling penalty. That is because they limit the ability of shippers to react to variations during a day in their need for gas without incurring a penalty."[87] In light of the fact that El Paso utilizes these comparatively burdensome hourly scheduling penalties, we find that it would be inappropriate for El Paso to structure its overrun penalty in such a way that would subject shippers to overrun penalties who flow gas within contractual limits and who would exceed their contractual limit only if El Paso were allowed to consider HEENs as the equivalent of flowing gas for overrun purposes.

66. Finally, El Paso argues that the Commission departed from precedent without explanation when it rejected inclusion of any HEEN quantities in the overrun calculation after accepting El Paso's proposal in 2005 to include 100 percent of HEEN quantities in the overrun calculation. As explained in the December 18 Order, the original 100 percent proposal was accepted by the Commission; however, it was not discussed at the technical conference or addressed by the Commission on the merits.[88] "[The Commission's] acceptance of a pipeline's tariff sheets does not turn every provision of the tariff into 'policy' or 'precedent.'"[89] Because the Commission simply accepted this aspect of the

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[86] *Columbia Gulf Transmission Co.*, 135 FERC ¶ 61,106, at P 86 (2011).

[87] *Id.*

[88] December 18 Order, 125 FERC ¶ 61,309 at P 79. The issue was ultimately resolved as part of the 2006 Rate Case Settlement, in which the parties agreed to the inclusion of 50 percent.

[89] *Gas Transmission Northwest Corp. v. Fed. Energy Reg. Comm'n*, 504 F.3d 1318, 1320 (D.C. Cir. 2007) (citing *Alabama Power v. Fed. Energy Reg. Comm'n*, 993

(continued…)

HEEN proposal without discussion, it is not precedential. We therefore reject El Paso's contention that the result reached here and in the December 18 Order somehow strays from established Commission precedent.

67. While we note that El Paso is under no obligation to offer any form of HEEN service,[90] where it does offer such a service, it cannot do so in a manner that is unjust and unreasonable. For the reasons discussed above, we find that the inclusion of any HEEN volumes in the overrun charge is unjust and unreasonable. This finding supports not only our determination to reject El Paso's proposal to include 100 percent of HEEN volumes in the overrun charge under section 4 of the NGA, but also our determination that El Paso must remove its existing tariff provision allowing for the inclusion of 50 percent of HEEN volumes in the overrun charge under section 5 of the NGA. Pursuant to section 5 of the NGA, and in light of the difference between HEENs and flowing gas for the purpose of calculating the overrun charge, we find that the inclusion of any HEENs in the overrun charge is unjust and unreasonable. Accordingly, El Paso's request for rehearing is denied on this point.

C. Non-Critical Penalty Rates

1. El Paso's Proposal

68. When El Paso made its initial filing in this matter on June 30, 2008, its existing non-critical condition rate for hourly scheduling penalties, daily unauthorized overruns, and Rate Schedule OPAS penalties was two times the interruptible transportation (IT) rate. El Paso explained that since it was proposing to charge short-term and interruptible services at a 250 percent firm rate equivalent, its non-critical condition penalty rates would increase two and one-half times. El Paso therefore proposed to change the non-critical penalty rates so that they would be based on the applicable firm or interruptible rate equivalent, instead of the IT rate. El Paso argued that this change would continue the pricing relationship for these penalty rates, and would assess penalties based on the type of service the shipper used.[91]

F.2d 1557, 1565 n.4 (D.C. Cir. 1993); *Nevada Power Co.*, 113 FERC ¶ 61,007, at 61,013-14 (2005)).

[90] *El Paso*, 114 FERC ¶ 61,305 at P 79.

[91] December 18 Order, 125 FERC ¶ 61,309 at P 60.

2. December 18 Order

69. In the December 18 Order, the Commission rejected El Paso's proposed non-critical penalty rates, finding them to be unjust and unreasonable because they would be based on the applicable rate schedules, rather than on the IT rate as required by Commission policy.[92] Noting its previous rejection of an El Paso proposal to implement non-critical penalties based on a 100 percent load factor of the corresponding rate schedule, the Commission explained its policy that pipelines may either 1) establish nominal penalties for non-critical periods tied to twice their IT rate, or 2) retain pre-Order No. 637 penalties, but waive the penalty if the shipper's conduct does not cause operational problems.[93] The nominal hourly scheduling penalty would be equal to the IT rate, and the nominal unauthorized overrun penalty would be equal to twice the IT rate.

70. The Commission found that if no change was made to El Paso's existing tariff, the non-critical penalties could increase to 250 percent of the IT rate (assuming the IT rate El Paso proposed in this proceeding was ultimately approved). The Commission explained that such an increase would be unreasonable and instead found that the use of a 100 percent load factor IT rate would be a reasonable non-critical penalty that stayed consistent with Commission precedent.[94]

71. The Commission further found that El Paso's hourly scheduling penalty should be the 100 percent load factor IT rate, and not two times the IT rate as was accepted in the 2006 Rate Case.[95] The Commission noted that a settlement of the 2006 Rate Case prevented it from addressing its acceptance of this hourly scheduling penalty on rehearing. The Commission explained that an hourly scheduling penalty based

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[92] *Id.* PP 62-63.

[93] *Id.* (citing *El Paso Natural Gas Co.*, 115 FERC ¶ 61,280, at PP 26-27 (2006)).

[94] *Id.* P 64 (citing *Regulation of Short-Term Natural Gas Transportation Services and Regulation of Interstate Natural Gas Transportation Services*, Order No. 637, FERC Stats. & Regs. ¶ 31,091, at 31,317, *clarified*, Order No. 637-A, FERC Stats. & Regs. ¶ 31,099, *reh'g denied*, Order No. 637-B, 92 FERC ¶ 61,062 (2000), *aff'd in part and remanded in part sub nom. Interstate Natural Gas Ass'n of Am. v. FERC*, 285 F.3d 18 (D.C. Cir. 2002), *order on remand*, 101 FERC ¶ 61,127 (2002), *order on reh'g*, 106 FERC ¶ 61,088 (2004), *aff'd sub nom. Am. Gas Ass'n v. FERC*, 428 F.3d 255 (D.C. Cir. 2005)).

[95] *Id.* P 65 (citing *El Paso Natural Gas Co.*, 114 FERC ¶ 61,305, at P 107 (2006)).

on 100 percent of the IT rate would provide an incentive for shippers to accurately schedule and would reasonably compensate the pipeline for lost opportunity costs.[96]

3. Request for Rehearing

72. In its rehearing request, El Paso states that its proposal in this proceeding was to continue to charge two times the IT or firm equivalent rate as the penalty rate in non-critical conditions.[97] El Paso also proposed to cap short-term services (including IT) at 250 percent of the related long-term recourse rate. El Paso argues that in the August 5 Order, the Commission set the issue of penalties during non-critical periods for hearing, and not for technical conference.[98] El Paso contends that there is no basis to conclude at this time that a penalty rate tied to a just and reasonable IT and short-term firm rate would be unreasonable, and that addressing the issue here arbitrarily prejudges the outcome of the rates that will be established after the hearing.[99] El Paso argues that at this stage, it is more appropriate to allow the penalty rate to be based on the effective IT or firm equivalent rate, and subject both the rates and the penalties to refund.

73. El Paso contends that in the December 18 Order, the Commission inexplicably rejected two aspects of its non-critical penalty rates: 1) holding that El Paso's non-critical penalties (which El Paso presumes includes both the unauthorized overrun charge and the hourly scheduling penalty) must be based on a 100 percent load factor IT rate, regardless of the short-term firm and IT rates ultimately approved in this proceeding; and, 2) holding that the hourly scheduling penalty should be further reduced to the 100 percent load factor IT rate, rather than two times the IT rate.[100] El Paso believes that these holdings run contrary to Commission precedent.

74. As an initial matter, El Paso seeks clarification of the Commission's use of the phrase "100 percent load factor IT rate" in the December 18 Order. El Paso states that the IT rate proposed by El Paso in this proceeding is a 100 percent load factor rate, and

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[96] *Id.* (citing *Columbia Gas Transmission Corp.*, 124 FERC ¶ 61,122, at P 10 (2008); *Natural Gas Pipeline Co. of Am.*, 103 FERC ¶ 61,174 (2003)).

[97] El Paso, Request for Rehearing at 14.

[98] *Id.* (citing Suspension Order, 124 FERC ¶ 61,124 at PP 27, 29).

[99] *Id.* at 16-17.

[100] *Id.* at 15. El Paso seeks clarification, or in the alternative rehearing, that the Commission did not intend to reduce the non-critical daily unauthorized overrun charge to the 100 percent load factor IT rate. *Id.* n.6.

that it differs from past IT rates because it is based on a 100 percent load factor of the 250 percent higher short-term firm rate (as opposed to being based on the Rate Schedule FT-1 rate).[101] El Paso assumes that the Commission uses the phrase "100 percent load factor IT rate" to mean a 100 percent load factor equivalent of the lower long-term FT-1 rate.

75. Additionally, El Paso asks the Commission to clarify that it intended for the non-critical penalties to be based on the 100 percent load factor long-term FT-1 rate. El Paso contends that if that is the case, the Commission is requiring El Paso to change the previously approved formula to establish non-critical penalty rates. El Paso asserts that the December 18 Order wrongly characterizes El Paso's proposed non-critical penalty rates for IT service as a change, explaining that it is continuing the practice of basing non-critical penalties for interruptible service on the IT rate.[102] Accordingly, El Paso argues that the Commission must justify why it is no longer just and reasonable for El Paso to base its penalty on two times the IT rate under section 5 of the NGA.

76. Moreover, El Paso contends that requiring hourly scheduling or daily unauthorized overrun charges to be divorced from the firm rate for the corresponding firm service is arbitrary and capricious. First, El Paso argues that the Commission has recognized that a scheduling penalty is intended, in part, to compensate a pipeline for lost opportunity costs,[103] which El Paso asserts are the revenues based on the actual rate for services not provided, not an arbitrary lower rate for service under a different rate schedule. El Paso asserts that to do otherwise would imply that all services consume the same amount of capacity, which is inconsistent with a Commission finding that non-ratable hourly services consume more capacity than ratable services.[104] Second, El Paso asserts that decoupling the unauthorized overrun rate from the actual service rate has even worse consequences because it will induce a shipper to rely on overrun service, rather than on contracting and scheduling firm service properly based on their needs. El Paso believes that such a result is contrary to the purpose of its transition to hourly services, and that it

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[101] *Id.* at 16.

[102] *Id.* (noting that El Paso has not proposed a change to the rate sheet applicable to non-critical penalties for IT service).

[103] *Id.* at 17 (citing *Columbia Gas Transmission Corp.*, 119 FERC ¶ 61,267, at PP 29-31 (2007)).

[104] *Id.* at 18 (citing *El Paso*, 114 FERC ¶ 61,305 at PP 39-42).

will give shippers the incentive to contract for a minimum level of hourly service, knowing that they can overrun their premium hourly contracts at the lower FT-1 rate.[105]

77. El Paso argues that if not reversed on rehearing, the Commission's determination would eviscerate El Paso's short-term rate proposal before it can be examined at hearing because no shipper would take short-term firm (at 250 percent of the 100 load factor rate) when it could pay a lower rate for unauthorized overrun service.[106] El Paso also contends that the Commission must explain its directive to reduce the penalty from two to one times the IT rate in light of its previous finding that El Paso's non-critical penalty rates equal to two times the IT rate were consistent with Commission policy.[107] El Paso contends that the Commission's earlier determination was made based on the merits of the proposal, and the fact that rehearing requests became moot due to a settlement does not mean that the Commission did not decide the merits of this issue. Accordingly, El Paso contends that the Commission must explain its departure from precedent in this case.

4. Commission Determination

78. Upon further consideration of El Paso's proposal, its arguments raised on rehearing, and our rejection of El Paso's proposal to increase its IT rate in the order on initial decision,[108] we deny El Paso's request for rehearing, in part, and grant El Paso's request for clarification, in part, as discussed below.

79. The December 18 Order's discussion about El Paso's non-critical penalty rates was premised on the presumption that El Paso's proposed increase of the short-term firm and IT rates (to 250 percent of the daily reservation rate applicable to long-term firm service), which was set for hearing, would go into effect after the five-month suspension period. Were such a rate increase to go into effect, El Paso's non-critical penalty rates would have simultaneously increased because El Paso proposed in this proceeding to change the non-critical penalty rates from two times the IT rate (which was equivalent to the 100 percent load factor rate for firm service provided under Rate Schedule FT-1) to

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[105] *Id.* 18-19 (citing *El Paso*, 114 FERC ¶ 61,305 at P 48).

[106] *Id.* at 19.

[107] *Id.* at 19-20 (citing *El Paso*, 114 FERC ¶ 61,305 at P 107).

[108] *El Paso Natural Gas Co.*, Opinion No. 517, 139 FERC ¶ 61,095, at PP 177-86 (2012).

two times the applicable firm or interruptible rate equivalent.[109] Accordingly, El Paso's proposal would assess penalties based on the type of service the shipper is using, either charging the interruptible rate, short-term firm rate or long-term firm rate, as applicable.[110]

80. In the Initial Decision, the administrative law judge rejected El Paso's proposal to increase the short-term firm and IT rate to 250 percent of the daily reservation rate applicable to long-term firm service.[111] In Opinion No. 517, the Commission upheld the Initial Decision on this point.[112] Because the Commission's discussion of El Paso's non-critical penalty rates in the December 18 Order was based, in part, on the 250 percent rate increase taking effect, the denial of El Paso's rate increase in Opinion No. 517 makes its request for rehearing largely moot.[113]

81. With respect to issues not expressly made moot by Opinion No. 517, we deny El Paso's request for rehearing of the December 18 Order's rejection of El Paso's proposal to base its non-critical penalty rates on the applicable rate schedule.[114] We note that this is not the first time El Paso has made such a request. The Commission has previously determined that the unauthorized overrun penalties El Paso may impose during non-critical periods may not exceed two times the maximum IT rate and the hourly scheduling penalties may not exceed the maximum IT rate.[115] Subsequent to the Commission making this finding, El Paso proposed tariff revisions that would base penalty amounts on the relevant rate schedule (for instance, Rate Schedule FT-H overrun charges would be

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[109] Ex. EPG-153 (Prepared Direct Testimony of Richard L. Derryberry), at 14, 31.

[110] *Id.* at 31-32.

[111] *El Paso Natural Gas Co.*, Initial Decision, 134 FERC ¶ 63,002, at P 293 (2011).

[112] *El Paso Natural Gas Co.*, Opinion No. 517, 139 FERC ¶ 61,095, at PP 177-186 (2012).

[113] *Id.* To the extent not made clear by this order and Opinion No. 517, we clarify, consistent with El Paso's request for clarification, that the Commission's use of the phrase "100 percent load factor IT rate" in the December 18 Order refers to a 100 percent load factor equivalent of the long-term FT-1 rate rather than a 100 percent load factor of the now-rejected short-term firm rate.

[114] December 18 Order, 125 FERC ¶ 61,309 at P 63.

[115] *El Paso Natural Gas Co.*, 114 FERC ¶ 61,305, at P 107 (2006).

based on the 100 percent FT-H rate).[116] The Commission rejected this proposal as inconsistent with the Commission's directive that penalties imposed during non-critical periods should be based on the IT rate.[117] Therefore, contrary to El Paso's assertion that the Commission should have waited until the outcome of the hearing to make this determination, the Commission appropriately decided that El Paso's proposal to tie its non-critical penalty rates to something other than the IT rate was inconsistent with Commission policy, as explained in the context of El Paso's own system as recently as 2006.[118]

82. Furthermore, El Paso has not provided a compelling reason for the Commission to change course and accept its proposal to tie non-critical penalty rates to the rate schedule under which the shipper incurred the penalty. As El Paso notes, the Commission has recognized that pipelines may establish a nominal scheduling penalty equal to the IT rate during non-critical periods, in part, because the IT rate reflects the pipeline's lost opportunity costs.[119] El Paso cites *Columbia Gas*, which explains that such costs are represented by the lost opportunity to sell the difference between the amount scheduled and the amount delivered as interruptible service.[120] Because the lost opportunity is an interruptible sale (as opposed to a sale of firm service), the Commission finds that the non-critical scheduling penalty should continue to be based on the IT rate, not on the rate schedule under which the penalty was incurred.

83. Moreover, the Commission upholds its determination in the December 18 Order that El Paso's hourly scheduling penalty should be further changed to the 100 percent load factor IT rate, not two times the IT rate as the Commission had previously accepted.[121] The Commission has repeatedly found that scheduling penalties during non-critical periods should be nominal, if imposed at all.[122] We, therefore, find pursuant to

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[116] *El Paso Natural Gas Co.*, 115 FERC ¶ 61,280, at P 26 (2006).

[117] *Id.* P 27.

[118] *Id.*

[119] *Columbia Gas Transmission Corp.*, 119 FERC ¶ 61,267, at PP 29-31 (2007) (citing *Natural Gas Pipeline Co. of Am.*, 103 FERC ¶ 61,174, at P 63 (2003)).

[120] *Id.* at n.19.

[121] December 18 Order, 125 FERC ¶ 61,309 at P 65.

[122] *Natural*, 103 FERC ¶ 61,174 at P 63; *Guardian Pipeline, L.L.C.*, 101 FERC ¶ 61,271, at P 27 (2002); *Williams Gas Pipelines Central, Inc.*, 100 FERC ¶ 61,232, at

(continued…)

section 5 of the NGA that El Paso's hourly scheduling penalty based on two times the 100 percent load factor IT rate was unjust and unreasonable in light of the fact that it went beyond imposition of simply a nominal penalty and exceeded El Paso's lost opportunity costs. We further uphold our determination that the just and reasonable hourly penalty rate is the nominal 100 percent load factor IT rate, and we therefore affirm the December 18 Order on this point.

84. While our decision requires El Paso to revise its hourly scheduling penalty to reflect the 100 percent load factor IT rate, it also allows El Paso to keep the unauthorized overrun rate at two times the 100 percent load factor IT rate. El Paso claims that without coupling the unauthorized overrun rate to the applicable rate schedule, shippers would have an incentive to rely on overrun service, rather than on contracting and scheduling firm service properly based on their needs. However, we find that keeping the unauthorized overrun rate at two times the IT rate is sufficient to deter any inappropriate shipper reliance on overrun service. Moreover, El Paso has not shown or provided evidence that a rate based on two times the IT rate is insufficient to achieve such deterrence.

D. Contracting Practices

1. Seasonal Shoulder Month Flexibility

a. El Paso's Proposal

85. In its June 30 Filing, El Paso proposed to remove from its tariff the seasonal shoulder month increase/decrease contract option. As a result of the 2006 Rate Case Settlement, seasonal shippers subscribing to the new services offered under Rate Schedules FDBS, FT-H, NNTD, and NNTH were allowed to elect to increase or decrease total contract demand for the shoulder months of April and/or October between fifty and one hundred fifty percent of their May through September total contract demand. Notwithstanding this 2006 Rate Case Settlement allowance, these services otherwise specifically provide that a shipper's seasonal contract quantity must remain uniform for each month of the season. El Paso argued that this shoulder month flexibility is no longer needed as it was a negotiated settlement item that allowed existing shippers a one-time

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P 21 (2002); *PG&E Northwest Pipeline Co.*, 98 FERC ¶ 61,365, at 62,569 (2002); *Panhandle Eastern Pipe Line Co.*, 97 FERC ¶ 61,046, at 61,269-71 (2001); *MIGC, Inc.*, 96 FERC ¶ 61,042 (2001); Order No. 637, FERC Stats. & Regs. ¶ 31,091, at 31,317, *clarified*, Order No. 637-A, FERC Stats. & Regs. ¶ 31,099, at 31,609.

opportunity to reduce or increase their contract demand during a shoulder month as they transitioned to the new service structure.[123]

b. December 18 Order

86. In the December 18 Order, the Commission accepted El Paso's proposal to eliminate the seasonal shoulder month accommodations for new conversions to premium service.[124] The Commission found that the seasonal shoulder month provision was included in the 2006 Rate Case Settlement as a new, one-time right that shippers could exercise within 60 days of the effective date of the settlement. The Commission further found that the provision appeared to be a transition mechanism for FT-1 shippers converting to premium services, and that shippers had notice that this right was only available for a specified time period. Noting that El Paso's proposal would not affect existing contracts that contain the seasonal shoulder month provision, the Commission stated that "[i]f a shipper exercises its [right of first refusal (ROFR)] rights in the future for these contracts, the seasonal shoulder month provisions will also not be affected."[125]

c. Request for Rehearing

87. In its rehearing request, El Paso seeks clarification of the Commission's reference to ROFR rights (quoted above) in the December 18 Order.[126] El Paso understands the Commission's statement to mean that shippers will have whatever ROFR rights they would otherwise have with respect to these shoulder month provisions. El Paso argues that it would be premature for the Commission to address this issue without an actual controversy and a concrete set of facts. Absent the requested clarification, El Paso seeks rehearing.

d. Commission Determination

88. The Commission grants El Paso's request for clarification. The above-quoted statement in the December 18 Order did not intend to pre-judge any case-specific issue that may arise with ROFR rights contained in existing contracts. Instead, the Commission intended to emphasize that El Paso's proposal to remove from its tariff the seasonal shoulder month increase/decrease contract option would apply to new contracts

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[123] December 18 Order, 125 FERC ¶ 61,309 at PP 152-53.

[124] *Id*. P 157.

[125] *Id*.

[126] El Paso, Request for Rehearing at 24.

only and would not affect existing contracts. Accordingly, we grant El Paso's request and clarify that under our acceptance of El Paso's proposal, shippers with existing contracts will have whatever ROFR rights they would otherwise have with respect to these shoulder month provisions.

2. Sculpted Maximum Daily Quantities

a. El Paso's Proposal

89. In its June 30 Filing, El Paso explained that the 2006 Rate Case Settlement permitted shippers to convert a sculpted (i.e., varying monthly contract quantities) FT-I contract to the new firm service options while retaining sculpted monthly delivery point rights (i.e., sculpted maximum delivery quantities (MDQ)). El Paso proposed to remove this provision from its tariff for the same reasons it sought to remove the seasonal shoulder month provision.[127] El Paso explained that it intended this provision to be a temporary transition mechanism, not a permanent right for new shippers, and noted that the removal of this provision would not change existing contracts. In addition, El Paso stated that the removal of this provision would give El Paso the opportunity to reduce unused monthly capacity over time.

b. December 18 Order

90. In the December 18 Order, the Commission accepted El Paso's elimination of the grandfathered sculpted MDQ provision. The Commission explained that in the 2006 Rate Case, El Paso was required to provide former full requirements shippers with varying monthly MDQs because there was insufficient capacity to serve their full needs. Sculpted MDQs enabled El Paso to meet the firm requirements of its shippers because the varying monthly needs of its shippers offset each other to a certain degree.[128] In the December 18 Order, the Commission found that sculpted MDQs can present contracting and management challenges for El Paso.[129] The Commission also found that El Paso was no longer in a constrained capacity situation, but instead had unsubscribed capacity. Because sculpted MDQs were no longer needed to meet the firm requirements of El Paso's shippers, the Commission accepted El Paso's proposal to eliminate the grandfathered sculpted monthly MDQ and conversion rights provision, with the caveat that El Paso may not reduce a shipper's level of service. Accordingly, the Commission

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[127] December 18 Order, 125 FERC ¶ 61,309 at P 158.

[128] *Id.* P 161 (citing *El Paso*, 114 FERC ¶ 61,305 at P 228).

[129] *Id.* P 162.

found that "El Paso may not reduce the shipper's MDQ for the remaining portion of the existing FT-1 contract below the highest monthly MDQ for that contract without mutual agreement with the shipper."[130]

c. Request for Rehearing

91. In its rehearing request, El Paso states that it is unclear whether the above-quoted statement by the Commission is directed only to this contract amendment/conversion discussion or more broadly to other contracting matters as well.[131] El Paso notes that shippers no longer have the right to amend existing contracts to convert capacity under the interim settlement provisions. Therefore, El Paso states, it must mutually agree with a shipper to the terms of any conversion. El Paso notes that while it cannot unilaterally reduce a shipper's MDQ, it may choose not to agree to a contract amendment if the amendment allowed a disproportionate partial conversion of a contract in which a shipper seeks to reduce its off-peak entitlement while retaining its full MDQ in peak months, thereby leaving El Paso with stranded capacity.[132] El Paso believes by allowing it to eliminate the transitional conversion right in the settlement, the Commission did not intend this result. El Paso therefore seeks clarification that shipper requests to amend, reform, and convert contracts (i.e., terminate existing contracts and enter into new ones) after January 1, 2009, require the mutual agreement of El Paso and the shipper.

92. In its rehearing request, Southwest Gas contends that the elimination of this tariff provision creates an unacceptable choice for FT-1 shippers with sculpted MDQs, forcing them either to forego premium service or give up historical contract rights to sculpted MDQs.[133] Southwest Gas contends that under El Paso's proposal, for a shipper to maintain its highest MDQ for FT-1 service within a season, the shipper partially converting to premium services would have to purchase additional FT-1 capacity. Southwest Gas contends that requiring shippers with sculpted MDQs to purchase additional FT-1 service in order to convert to premium services is an unreasonable impediment to open access. Southwest Gas further argues that such a requirement is not

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[130] *Id.*

[131] El Paso, Request for Rehearing at 21.

[132] *Id.* at 21-22.

[133] Southwest Gas, Request for Rehearing at 3-4.

supported by *Mobile-Sierra* public interest determinations, and it exceeds the Commission's statutory authority.[134]

93. Southwest Gas claims that the Commission provided no support for its justifications to eliminate the sculpted MDQ tariff provision. Southwest Gas contends that El Paso's claim that contracting and management challenges result from sculpted MDQs is illusory. Southwest Gas argues that retention of the grandfathering provision will actually assist, not harm, El Paso by reducing the amount of capacity with sculpted MDQs.[135]

94. Southwest Gas contends that El Paso has not identified any specific management challenge presented by sculpted MDQs. Southwest Gas also states that El Paso will not be financially harmed by retention of the grandfathered sculpting provision because the additional revenues from premium services will keep El Paso revenue neutral for managing premium service and any remaining FT-1 capacity.[136] Southwest Gas also points out that El Paso is not required to permit conversion because the settlement provision allowing conversion has expired. Accordingly, Southwest Gas contends where El Paso agrees to a conversion from FT-1 service to premium service, one can presume that El Paso benefits from the conversion.[137]

95. Southwest Gas also argues that the Commission's finding that sculpted MDQs can present contracting challenges is not supported by concrete evidence.[138] Southwest Gas states that neither the Commission nor El Paso cited evidence that the varying monthly needs of shippers has changed on the El Paso system and that there is no evidence that sculpted MDQs affect El Paso's ability to market capacity. Southwest Gas contends that the grandfathering provision does not increase the amount of capacity subject to sculpting, and in fact, the opposite is true—conversions under the provision will reduce

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[134] *Id.* at 4 (referencing *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956) (*Mobile*); *Federal Power Comm'n v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956) (*Sierra*)).

[135] *Id.* at 5.

[136] *Id.*

[137] *Id.* at 5-6.

[138] *Id.* at 6.

the capacity subject to sculpting as well as any marketing risk associated with this off-peak capacity.[139]

96. Southwest Gas argues that the Commission's explanation for eliminating the grandfathering provision is not rationally related to the problem of unsubscribed capacity. Southwest Gas states that shippers with sculpted MDQs have a financial disincentive for converting to premium services if they must give up sculpting rights on remaining FT-1 contracts because they would have to pay higher rates for the premium services, as well as contract for additional FT-1 capacity. Southwest Gas argues that because premium services require greater capacity than FT-1 service, this will increase stranded capacity. Moreover, Southwest Gas argues that the Commission did not cite any evidence to support changed market conditions, stating that El Paso's alleged future remarketing difficulties are hypothetical concerns with no demonstrations that shippers have been unable to contract for whatever capacity they require.[140]

97. Southwest Gas argues that eliminating sculpted MDQs for FT-1 shippers that partially convert to premium service before the end of a contract term will not lead to El Paso's desired goal of reducing sculpted MDQs. Moreover, Southwest Gas states that it is an arbitrary restriction to prevent one class of shippers from retaining sculpted MDQs while permitting others to obtain sculpted MDQs.[141] Southwest Gas explains that both FT-1 shippers with sculpted MDQs and premium service shippers with sculpted shoulder month MDQs can retain the sculpted MDQs for the duration of their existing contracts as well as under new contracts at the end of an existing contract term through the right of first refusal process (ROFR).[142] Southwest Gas argues that in light of these allowances, there is no logical basis to force FT-1 shippers to give up sculpted rights in order to partially convert to premium service during a contract term.

98. Southwest Gas compares El Paso's conditioning access to premium service in a partial contract conversion with forcing a shipper to purchase additional capacity in order to retain its service at the end of a contract term.[143] Southwest Gas contends that forcing FT-1 shippers to forgo their existing contract rights in order to gain access to El Paso's

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[139] *Id.* at 7.

[140] *Id.* at 7-8.

[141] *Id.* at 8-9.

[142] *Id.* at 9.

[143] *Id.* at 10.

premium services requires them to purchase unwanted FT-1 service. Southwest Gas believes this to be an unreasonable imposition on access to premium services that unduly discriminates against former full requirements customers and distorts the efficient use of services by shippers.[144] Southwest Gas contends that it is unreasonable for a pipeline to tie a shipper's purchase of a premium hourly service to the purchase of unwanted capacity.[145]

99. Southwest Gas next argues that the elimination of the grandfathering provision constitutes a contract change that requires a public interest determination under *Mobile-Sierra*.[146] Southwest Gas reasons that sculpted MDQs represent shipper service rights reflected in mutually agreed upon contracts between shippers and El Paso. Southwest Gas asserts that requiring an FT-1 shipper to increase its MDQs in order to partially convert to premium service is an unjustified contract change. Southwest Gas contends that the Commission's reliance on alleged changed market conditions is no basis upon which to change shippers' historical rights. Southwest Gas states that there has not been a demonstration justifying the change that meets the public interest standard, and that, in fact, the public interest is served by retaining the provision. Southwest Gas argues the Commission and the courts have recognized that market changes do not justify contract abrogation under the *Mobile-Sierra* standard.[147] Southwest Gas contends that eliminating the grandfathering provision would be particularly unreasonable given that sculpted MDQs were approved by the Commission under the *Mobile-Sierra* standard.[148]

100. Finally, Southwest Gas argues that elimination of the grandfathering provision exceeds the Commission's authority because it would require an FT-1 shipper to purchase unwanted FT-1 service.[149]

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[144] *Id.*

[145] *Id.* at 11.

[146] *Id.* at 12 (referencing *Mobile*, 350 U.S. 332; *Sierra*, 350 U.S. 348).

[147] *Id.* at 13 (citing *Morgan Stanley Capital Group Inc. v. Pub. Util. Dist. No. 1*, 554 U.S. 527 (2008) (*Morgan Stanley*).

[148] *Id.* (citing *El Paso Natural Gas Co.*, 104 FERC ¶ 61,045, at PP 44, 93 (2003), *aff,d*, *Arizona Corp. Comm. v. FERC*, 397 F.3d 952 (D.C. Cir. 2005)).

[149] *Id.* at 14.

d. Commission Determination

101. As an initial matter, we grant El Paso's request for clarification that shipper requests to amend, reform, and convert contracts (i.e., terminate existing contracts and enter into new ones) after January 1, 2009, require the mutual agreement of El Paso and the shipper. In this case, El Paso is eliminating a tariff provision that gave shippers the right to reduce their sculpted MDQs under an FT-1 contract by contracting for one of El Paso's new service options while retaining sculpted monthly delivery point rights under the FT-1 service agreement. Under El Paso's proposal, conversions from sculpted firm service to other service options must be completed with the mutual agreement of both El Paso and the shipper.

102. The Commission does not require pipelines to permit customers to terminate or reduce their contract demand before the end of the contract terms.[150] In *Northern Natural*, the Commission accepted a pipeline's proposal to eliminate certain hardship reduction rights. The Commission explained that the pipeline voluntarily offered such reduction rights in the past, as it was under no obligation to do so. The Commission further explained that the pipeline's voluntary discretion was not somehow curtailed simply because the pipeline offered these rights in the first instance.[151] Accordingly, the pipeline was free to eliminate such rights. The same logic applies here. Commission policy does not require El Paso to permit customers to reduce their contract demand before the end of the contract terms, nor does it require that certain non-conforming provisions of a contract be carried forward when a shipper does seek to reduce its contract demand and enter into a new agreement under a new rate schedule. Accordingly, we grant El Paso's request for clarification that the terms of any contract reduced or amended must be completed with the mutual agreement of both El Paso and the shipper.

103. We will deny Southwest Gas's request for rehearing. Southwest Gas's rehearing request is premised on the notion that El Paso is obligated to retain a tariff provision, established via settlement of El Paso's 2006 Rate Case, that provides shippers with the unilateral right to partially convert sculpted FT-1 agreements to take advantage of El Paso's premium services while retaining the benefit of sculpting under the FT-1 service agreement. Southwest Gas, however, provides no support for the contention that El Paso must retain this provision beyond the term of the settlement, nor does it show that such a

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[150] *See Northern Natural Gas Co.*, 133 FERC ¶ 61,103 (2010), *reh'g denied*, 135 FERC ¶ 61,024, at P 19 (*Northern Natural*) (citing *Columbia Gulf Transmission Co.*, 105 FERC ¶ 61,351, at P 11 (2003)).

[151] *Northern Natural*, 135 FERC ¶ 61,024 at PP 21-22.

provision is required by Commission policy. As explained in *Northern Natural*, the Commission will accept a pipeline proposal to remove a right that it provided on a voluntarily basis, so long as there is no undue discrimination among shippers.[152] Because that is what El Paso seeks to do here, and because El Paso's proposal will apply to all shippers on an equal basis, we will deny Southwest Gas's request for rehearing on this point.

104. Southwest Gas disputes the Commission's determination that "sculpted MDQs can present contracting and management challenges for El Paso,"[153] arguing that these determinations were not supported by substantial evidence. We disagree. As the Commission explained, sculpting MDQs allowed El Paso to maximize its capacity when such capacity was constrained; however, sculpting is no longer needed because El Paso's system is no longer constrained and instead has unsubscribed capacity.[154] In light of the fact that El Paso now faces the issue of having unsubscribed capacity, the sculpted MDQs now pose difficulties to El Paso in managing and contracting for off-peak capacity that has no associated peak capacity.

105. For this reason, the Commission found in the December 18 Order, as it had previously found on El Paso's system, that such sculpting posed management and contracting difficulties to El Paso.[155] These difficulties provide sufficient justification for El Paso to remove the provision that would allow shippers to unilaterally reduce their FT-1 contract amounts while retaining the benefit of sculpted MDQs on the remaining FT-1 contract amount. Accordingly, El Paso is entitled to amend its tariff in a way that appears designed to phase such rights out as contracts expire and are not renewed. Contrary to Southwest Gas's assertions, nothing in El Paso's proposal forces or coerces shippers with sculpted MDQs in existing contracts to actually reduce these rights. Instead, the proposal merely eliminates the right for shippers to modify such contracts while at the same time retaining the benefits of sculpting under their FT-1 service agreements.

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[152] *Id.* P 19.

[153] December 18 Order, 125 FERC ¶ 61,309 at P 162.

[154] *Id.* Contrary to Southwest Gas's suggestion, the Commission's finding that market conditions on El Paso had changed was supported by substantial evidence. *See* El Paso, October 10, 2008 Reply Comments at 36 (citing Ex. EPG-69 (Catherine Palazzari Affidavit) at 11-12, 16, 22 (providing examples of turned back capacity and noting the increased risk to El Paso associated with remarketing this capacity)).

[155] *Id.* P 161 (citing *El Paso*, 114 FERC ¶ 61,305 at P 229).

106. Southwest Gas believes that acceptance of this provision will pose a disincentive to shippers who may otherwise reduce their sculpted FT-1 contracts, thereby resulting in more sculpted capacity than would otherwise be the case. This argument is not persuasive. Whether El Paso's proposal would provide an incentive for shippers to reduce FT-1 capacity subject to sculpting is not the issue. The Commission understands El Paso's proposal as intended to phase out sculpted FT-1 contracts through contract expiration or through mutual agreement with customers who have sculpted capacity rights. Were the Commission to require El Paso to retain the provision allowing shippers to reduce sculpted FT-1 contracts, shippers would likely retain their sculpted MDQs (even if they converted part of their contracts to El Paso's new premium services). Thus, any reduction in the amount of capacity subject to sculpting would do little to phase out these sculpted agreements, and the amount of off-peak capacity with no associated peak capacity would likely remain unchanged.

107. Additionally, Southwest Gas misconstrues the nature of the provision El Paso seeks to remove in this proceeding. The provision that El Paso seeks to remove is section 2.8 of its FT-1 rate schedule. Southwest Gas contends that this provision is a contract right subject to the *Mobile/Sierra* public interest standard. It is not. This tariff section is no longer subject to the 2006 Rate Case Settlement. Accordingly, El Paso is free to modify and/or remove it, so long as it shows that the proposal is just and reasonable and not unduly discriminatory under section 4 of the NGA. As indicated above, where there is no Commission policy requiring such a provision, and El Paso has provided reasons sufficient to show that the proposal is just and reasonable, we will accept the proposal.

108. Accordingly, we uphold the December 18 Order on this point. El Paso is not required to maintain this tariff provision, either by settlement or by Commission policy, and sufficient grounds exist upon which to accept its removal.

3. Grandfathered Pressure Commitments

a. El Paso's proposal

109. In its June 30 Filing, El Paso proposed to remove the grandfathered right to pressure commitments when shippers convert to an El Paso premium service. El Paso stated that the grandfathered pressure commitments accommodation was a negotiated settlement item that El Paso intended as a temporary transition mechanism and not as a permanent right for new shippers. El Paso asserted that the removal of the grandfathered

pressure commitment may result in increased lateral capacity sales or lateral flexibility over time.[156]

b. December 18 Order

110. In the December 18 Order, the Commission accepted El Paso's proposed elimination of the grandfathered pressure commitments for converted contracts, subject to modification.[157] The Commission explained that the grandfathered pressure commitment provision allowed FT-1 shippers who re-contracted to FT-H hourly service to have a grandfathered right to the FT-1 pressure commitment for the period of the original term of the FT-1 contract. El Paso's proposal would allow existing FT-1 shippers to continue to have the pressure commitments contained in the existing FT-1 contracts; however, the ability to include FT-1 pressure commitments in new hourly services would be eliminated. The Commission found this change to be just and reasonable because the grandfathering of pressure commitments was a transitional feature. The Commission also found that El Paso could not continue to offer these pressure commitments because hourly service requires more capacity and is more difficult to manage. The Commission noted that pressure commitments in existing contracts will not be affected by this change. The Commission emphasized that if a shipper converts a portion of its existing FT-1 contract to a new service, the shipper should retain the pressure commitment for the remaining portion of its FT-1 contract. Because El Paso's tariff was unclear on this point, the Commission directed El Paso to modify its tariff accordingly.[158]

c. Request for Rehearing

111. In its rehearing request, El Paso notes that although the Commission accepted El Paso's proposal to eliminate grandfathered pressure commitments, the Commission stated that if a shipper converts a portion of its existing FT-1 contract to a new service, the shipper should retain the pressure commitment for the remaining portion of its FT-1 contract.[159] El Paso requests clarification that it must agree to any requested amendment, partial or otherwise, as well as any pressure commitments that can be provided in

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[156] December 18 Order, 125 FERC ¶ 61,309 at P 163.

[157] *Id*. P 168.

[158] *Id*.

[159] El Paso, Request for Rehearing at 22 (citing December 18 Order, 125 FERC ¶ 61,309 at P 168).

connection with either the amended FT-1 contract or the new hourly service contract. In the alternative, El Paso requests rehearing.

112. El Paso states that if it agrees with a shipper to amend an existing FT-1 contract to reduce the shipper's MDQ, and the shipper then subscribes to a premium hourly service, El Paso may not be able to provide the same pressure commitment.[160] El Paso explains that whether it can provide pressure commitments is a function of a number of variables, including volumes to be delivered over varying time periods, delivery point locations, and expected loads upstream and downstream from the delivery point. El Paso states that a change in the type of service would also have an impact on the pressure level El Paso could provide because providing hourly peak services requires additional capacity.[161] El Paso says that it will provide such firm service commitments on a not unduly discriminatory basis if its system requirements permit; however, El Paso contends that it should be able to exercise its operational judgment to determine whether, and to what extent, pressure commitments can be provided based on the operating parameters existing at the time of any such request.[162]

d. Commission Determination

113. For the same reasons discussed in the preceding section,[163] we grant El Paso's request for clarification that where a shipper converts a portion of its existing FT-1 contract to a new service, any change in the pressure commitments to residual service provided under the FT-1 rate schedule is subject to the mutual agreement of the shipper and El Paso.[164] El Paso is under no obligation to provide grandfathered pressure commitments to customers that, of their own accord, seek to convert or reduce the contract quantity of existing contracts in favor of taking service under El Paso's premium

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[160] *Id*. at 22-23.

[161] *Id*. at 23.

[162] *Id*. at 23-24.

[163] *See supra* PP 102-03 (discussing *Northern Natural*, 135 FERC ¶ 61,024 at PP 19-22).

[164] We note that El Paso is bound by the terms of its tariff in agreeing or rejecting pressure commitments made by shippers. For example, section 13.9 of El Paso's General Terms and Conditions requires it to provide a requesting shipper with written explanation of the operational basis for rejecting any request for a maximum or minimum contract pressure. El Paso, Request for Rehearing at 23, n.11.

services. Accordingly, El Paso was free to remove this provision, and as the Commission found in the December 18 Order, El Paso justified the provision by pointing to the increased capacity demands of its hourly services and the difficulties associated with managing different pressure commitments.[165] We therefore grant El Paso's requested clarification.

E. Strained and Critical Operating Condition (SOC/COC) Penalties

1. December 18 Order

114. In response to El Paso's June 30 Filing, EGC raised objections to El Paso's existing SOC/COC penalty provisions, which El Paso did not propose to change in this proceeding. EGC argued that El Paso should charge only the non-critical penalty if a shipper packs or drafts in the opposite direction of an SOC/COC.[166] EGC further argued that shippers who are net packers of the system during draft SOCs should be acknowledged as helping and penalized for hourly excesses only on a non-critical basis.

115. El Paso opposed EGC's request, arguing that because it addresses issues that are not part of El Paso's June 30 Filing, it must be adjudicated under section 5 of the NGA.[167] On the merits, El Paso explained that if a shipper exceeds its hourly entitlement during a critical operating condition period, it should be penalized the critical condition hourly penalty, regardless of whether it packed the system on a daily basis during a draft SOC/COC, as this can prevent El Paso from maintaining contract pressures at that location or cause a drop in pressure at other locations.

116. In the December 18 Order, the Commission rejected EGC's request that El Paso only charge the non-critical SOC/COC penalty if a shipper packs or drafts in the opposite direction of an SOC/COC, finding that EGC had not met its burden under section 5 of the NGA to demonstrate that El Paso's current non-critical condition penalty provision is unjust and unreasonable.[168] The Commission accepted El Paso's contention that these penalties are necessary for operational reasons and found that EGC failed to demonstrate that the existing non-critical condition penalty provision was unnecessary.

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[165] December 18 Order, 125 FERC ¶ 61,309 at P 168.

[166] *Id*. P 123.

[167] *Id*. P 124.

[168] *Id*. P 125.

2. Request for Rehearing

117. In its rehearing request, EGC again argues that where a shipper drafts El Paso's system in some hours, but otherwise packs the system throughout the course of the day, it should be seen as relieving a draft SOC/COC, which El Paso declares on a daily, not hourly, basis.[169] EGC argues that in this situation, the shipper is assisting El Paso's operations during a critical condition by helping to maintain pressure. EGC therefore argues that it is unjust and unreasonable for El Paso to charge the shipper the extreme critical condition hourly scheduling penalty when the shipper is actually helping relieve the critical daily condition. EGC contends that if shippers helping relieve a critical condition are not treated more leniently, there will be less incentive for them to assist El Paso relieving critical conditions.[170]

118. EGC further argues that it is unduly discriminatory for El Paso to charge shippers with excess hourly takes over many hours during a pack SOC/COC only the lower non-critical condition hourly scheduling penalty, but not afford shippers with excess takes in only a few hours the same treatment during a draft SOC/COC, where the latter shipper is packing the system during the course of the day and otherwise helping relieve the critical condition. EGC points out that El Paso has consistently denied requests for waiver of critical hourly scheduling penalty, even where the shipper acted to relieve the draft SOC/COC. At minimum, EGC urges the Commission to require El Paso to consider in good faith requests for waiver of the critical condition hourly scheduling penalties. EGC further urges the Commission to impose a rebuttable presumption that grounds for a waiver exist in the situation described above, where the shipper helps El Paso relieve an SOC/COC on a net basis.[171] EGC emphasizes that it is not requesting that a shipper with excess hourly takes avoid imposition of the hourly scheduling penalty altogether—only that where the shipper helps relieve an SOC/COC, the shipper should only be assessed the non-critical condition penalty, thereby providing an incentive for the shipper to help relieve the critical condition.

3. Commission Determination

119. We will deny EGC's request for rehearing on this point. Because El Paso has not proposed to change the SOC/COC penalties, we evaluate EGC's requested revision under section 5 of the NGA. (In its rehearing request, EGC does not dispute that this is the

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[169] EGC, Rehearing Request at 2-3.

[170] *Id.* at 4.

[171] *Id.* at 4-5.

appropriate standard.) EGC contends that it is "manifestly unjust and unreasonable" for El Paso to charge shippers the critical condition hourly scheduling penalty when the shipper helps relieve a critical daily condition, such as by packing the system over the course of a day when a draft SOC/COC has been issued, even though it may have drafted the system during some hours of that day.

120. We disagree. Under El Paso's tariff in existence at the time of its filing, El Paso charges the non-critical condition penalty for any hourly scheduling penalty or daily unauthorized overrun penalty assessed for actions in the opposite direction in the affected area during the SOC or COC, whether or not El Paso requested the shipper to go out of balance in that direction.[172] Thus, under El Paso's tariff in effect at the time, a shipper is not penalized at the critical rate where its actions help relieve the critical condition. However, EGC seeks to be further relieved of critical condition hourly scheduling penalties during hours in which a shipper's actions *exacerbate* the critical condition so long as over the course of the day, the shipper's actions are in the opposite direction of the critical condition. We find that such relief would contravene the purpose of the critical condition penalty, i.e., to allow the pipeline to impose penalties necessary to prevent the impairment of reliable service, particularly during critical or strained operating periods.[173] Therefore, we uphold the December 18 Order's determination that EGC did not meet its section 5 burden to show that El Paso's existing penalties were unjust and unreasonable.

121. We also deny EGC's request to establish a rebuttable presumption that grounds for a waiver exist in the situation described above, where the shipper assists El Paso relieve a SOC/COC on a net basis during the course of the day. We presume that any waiver requests will be evaluated on a good faith basis. However, we decline to establish a presumption that actions during certain hours of the day that exacerbate a strained or critical condition should be granted waiver of the critical condition penalty, simply because they may net out over the course of the day. Again, EGC has not met its burden

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[172] El Paso, FERC Gas Tariff, General Terms and Conditions, § 33.9.

[173] *See* Order No. 637, FERC Stats. & Regs. ¶ 31,091, at 31,317 ("the need to maintain system integrity during critical days is of sufficient importance that the Commission does not want to limit the pipelines' ability to deter conduct that may be harmful to other shippers even if it cannot provide current information."). *See also Gulf South Pipeline Co., LP*, 98 FERC ¶ 61,278, at 62,178-79 (2002) (rejecting a "no harm/no foul" request from shippers in which shippers would not be penalized unless the pipeline makes a showing of actual harm because the pipeline should not be required after-the-fact to identify which violations have helped and which violations have hurt the system).

to show that El Paso's existing penalty and waiver provisions are unjust and unreasonable. Accordingly, EGC's request for rehearing of this point is denied.

F. Definition of Hourly Scheduling Penalty

1. El Paso's Proposal

122. In its June 30 Filing, El Paso proposed to modify the definition of "Hourly Scheduling Penalty Quantity" in section 1.33 of its tariff to include the statement that "the hourly scheduling penalty quantity consists of two components, a scheduling quantity and an overrun quantity."[174]

2. December 18 Order

123. In the December 18 Order, the Commission accepted El Paso's proposed modification to the definition of hourly scheduling penalty.[175] The Commission found that El Paso's proposed revision merely clarifies that the hourly scheduling penalty is composed of a scheduling penalty component and an overrun component and does not change the penalty itself. The Commission noted that the hourly scheduling penalty may not contain an overrun component if the delivered quantities are within contract levels, but in excess of scheduled amounts. The Commission explained, however, that if the delivered quantities exceed contract levels, El Paso is entitled to recover the cost of providing that overrun service, as provided in its tariff.

3. Request for Rehearing

124. In its rehearing request, EGC states that by holding that El Paso's hourly scheduling penalties do not have an overrun component when "delivered quantities are within contract levels," the Commission must have meant that this occurs when a shipper's excess hourly takes in a given day do not cause the shipper to overrun its maximum *daily* contract quantities.[176] EGC notes that El Paso's service agreements only have maximum daily, not hourly, contract quantities. Accordingly, EGC requests that the Commission clarify the December 18 Order to make clear that an hourly scheduling penalty has an overrun component only to the extent that excess hourly takes in a given day cause the shipper to exceed its maximum daily contract quantities.

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[174] December 18 Order, 125 FERC ¶ 61,309 at P 114.

[175] *Id.* P 117.

[176] EGC, Rehearing Request at 5-6.

4. Commission Determination

125. We deny EGC's request for clarification. In the December 18 Order, the Commission explained that El Paso's revision to the Hourly Scheduling Penalty Quantity definition "merely clarifies that the hourly scheduling penalty is composed of a scheduling penalty component and an overrun component."[177] Accordingly, the Commission understood El Paso's proposal to maintain the existing penalty structure, subject only to the clarification required by the Commission in a previous order, and proposed by El Paso in this proceeding, i.e., to properly differentiate between overruns and scheduling penalties.[178] Prior to its filing in this proceeding, El Paso's existing penalty structure included hourly overrun penalties, even where a shipper remained under its contract demand for the day. EGC seeks for the Commission to interpret a line in the December 18 Order—"that the hourly scheduling penalty may not contain an overrun component if the delivered quantities are within contract levels"—in a way that would prohibit El Paso from recovering hourly overrun penalties if the shipper did not exceed its contract demand for the day. Because such an interpretation would change the nature of El Paso's penalty structure beyond the scope of El Paso's proposal and in a way not intended by the Commission, we deny EGC's request for clarification on this point.

G. The Inclusion of California Border Spot Prices in the Monthly Index

1. El Paso's Proposal

126. In its June 30 Filing, El Paso proposed to revise the monthly spot price for its monthly system cash-out index price to include a California border spot price.[179] El Paso argued that with the pending addition of new California flows related to North Baja receipt points, and customer-requested change to Rate Schedule PAL for California park and loan activity, it was appropriate to add the California border spot price to cash-out and daily spot price determinations. El Paso explained that because shippers' economic decisions may often be based on the price of gas in California, modifying the monthly cash-out index price will better reflect market sensitivities to California as an El Paso system pricing indicator.

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[177] December 18 Order, 125 FERC ¶ 61,309 at P 117.

[178] *El Paso*, 114 FERC ¶ 61,305 at P 130 (finding that El Paso misemployed the term "overrun" and requiring it to revise its tariff to reflect that overruns are "quantities of gas taken in excess of a shipper's contract demand").

[179] December 18 Order, 125 FERC ¶ 61,309 at P 106.

2. December 18 Order

127. In the December 18 Order, the Commission found El Paso's proposal to revise the monthly spot price to include a California border spot price to be just and reasonable, as it would ensure that the monthly spot price will reflect the effect of California spot prices on the overall system index price.[180] The Commission found that it was unnecessary to require El Paso to demonstrate that it purchases gas from California receipt points, as requested by protesters, because the system cash-out price is calculated based on a weighted average of the monthly San Juan and Permian Basin index prices. Furthermore, El Paso's tariff provides that the calculation of the system average rate is based on receipt quantities. Therefore, the Commission found, if El Paso does not purchase any gas at California receipt points, the cash-out price will accurately reflect this and will not be improperly influenced by California prices.[181] The Commission also found that including the California prices in the cash-out calculation will not enrich El Paso because revenues net of costs must be refunded to shippers.

3. Requests for Rehearing

128. In their rehearing request, Indicated Shippers contend that the Commission erred when it stated that "if El Paso does not *purchase any gas* at California receipt points, the cash-out price will accurately reflect this and will not be improperly influenced by California prices."[182] Indicated Shippers state that under El Paso's tariff, El Paso will determine the "Monthly System Cash-Out Index Price by using a weighted average of the Monthly Permian Index Price, the Monthly San Juan Basin Index Price, and the Monthly California Border Cash-out Index Price."[183] Indicated Shippers further state that El Paso will base the weighting on "the quantities entering El Paso's system in each Production Area and scheduled as a California receipt during the previous quarter."[184] Therefore, Indicated Shippers state, the Monthly System Cash-Out Index Price is based on where gas is *received* onto El Paso's system, not where El Paso *purchases* gas. Accordingly,

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[180] *Id.* P 112.

[181] *Id.* P 113.

[182] Indicated Shippers, Request for Rehearing at 6-7 (citing December 18 Order, 125 FERC ¶ 61,309 at P 113) (emphasis added).

[183] *Id.* at 7 (citing El Paso, FERC Gas Tariff, General Terms and Conditions, section 32.2(c)(iv), Proposed Third Revised Sheet No. 362).

[184] *Id.*

Indicated Shippers seek clarification that the Commission did not intend to modify El Paso's cash-out mechanism by basing it on where El Paso makes purchases, as opposed to the weighted average of shipper receipt quantities. In the event that the Commission intended to modify El Paso's cash-out mechanism in this way, Indicated Shippers seek rehearing because it would grant El Paso too much influence over the Monthly System Cash-Out Index Price and would not reflect system activity.[185]

129. In its rehearing request, Golden Spread urges the Commission to require El Paso to restrict the index sources used to derive the daily index price component of its critical condition hourly scheduling penalty to the Permian, West Texas, and Waha index prices for those shippers taking service in the Permian Basin area and paying Production Area rates. Golden Spread argues that Permian Basin area shippers that are paying Production Area rates should not be exposed to the California or San Juan index prices in the Daily Mid-Point Spot Price component of El Paso's critical condition penalties.[186] Golden Spread notes that El Paso defines this penalty rate as the higher of the Daily Mid-Point Spot Price or the Monthly System Cashout Index Price. Golden Spread explains that it did not object to El Paso's proposal to include the California border price in determining the Monthly System Cashout Index Price; its only concern was with the exposure to California or San Juan index prices in the Daily Mid-Point Spot Price.

130. Golden Spread states that the December 18 Order did not directly address their arguments on this point. Golden Spread explains that while the Commission suggested that the purchase of gas at the California border is a precondition to use of that price in the Monthly System Cashout Index Price component of the penalty structure (which is a function of the weighted average approach El Paso uses to derive the cashout index price), the California border price applies in the Daily Mid-Point Spot Price component of the penalty *irrespective* of where gas is actually purchased.[187] Golden Spread contends that because the Daily Mid-Point Spot Price reflects the highest spot price for the day, as opposed to a weighted average price, the Commission's reasoning relies on a factual premise that is not present for that particular price. Accordingly, Golden Spread contends that based on historical practices, the California border index price (which is generally higher than other daily index prices) will be used to establish the Daily Mid-

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[185] *Id*.

[186] Golden Spread, Request for Rehearing, at 3-4.

[187] *Id*. at 5.

Point Spot Price component of El Paso's critical condition hourly scheduling penalty in most circumstances.[188]

131. Golden Spread notes that by definition, Permian Basin area shippers who pay Production Area rates cannot receive gas from or deliver gas to either the San Juan Basin or the California border. Because of this narrow scope of Production Area service, Golden Spread believes the sources of the index prices used to derive the critical condition hourly scheduling penalty should be similarly narrow.[189] Golden Spread argues that the Commission's failure to limit the Daily Mid-Point Spot Price to Permian, Waha and West Texas prices for Permian Basin area shippers paying Production Area rates was arbitrary and capricious. Golden Spread asserts that, for the reasons discussed above, the Commission incorrectly reasoned that such shippers would be exposed to California border prices only when gas was purchased at the California border. Furthermore, Golden Spread states that the Commission's decision creates an unreasonable conflict between the way the monthly cashout prices are determined and applied to the transportation imbalances of Permian Basin area shippers who pay Production Area rates and the way the daily index prices are used to calculate the critical condition hourly scheduling penalties for those same shippers.

4. Commission Determination

132. We grant Indicated Shippers' request for clarification regarding the make-up of the Monthly System Cash-Out Index Price. We acknowledge that the Monthly System Cash-Out Index Price is based on where gas is *received* onto El Paso's system, not where El Paso *purchases* gas. The December 18 Order did not intend to modify El Paso's proposal to base the Monthly System Cash-Out Index Price on where El Paso purchases gas. Accordingly, we grant Indicated Shippers' request for clarification.

133. We deny Golden Spread's request for rehearing regarding El Paso's proposal to use the California index price in determining the Daily Mid-Point Spot Price and, in turn, the critical condition hourly scheduling penalty rate. In short, Golden Spread is concerned that the California border price (which tends to be higher than the other index prices), will most often set the Daily Mid-Point Spot Price because that price is a "highest of" price rather than a "weighted average" price. Moreover, because the critical condition hourly scheduling penalty is based on the higher of the Daily Mid-Point Spot Price or the Monthly System Cash-Out Index Price, Golden Spread fears that the California border price will often end up setting the critical condition hourly scheduling

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[188] *Id.* at 6.

[189] *Id.* at 6-7.

penalty across El Paso's system, even for Permian Basin shippers who cannot receive or deliver gas to the California border or the San Juan Basin.

134. We acknowledge Golden Spread's concern that the critical condition hourly scheduling penalty may be set by the California border price. However, we do not believe this to be an inequitable result. First, El Paso's proposal must be placed in context. El Paso has proposed its revision to the critical condition hourly scheduling penalty in the context of otherwise reducing the penalty rates applicable to critical operating periods. Second, the inclusion of the California border price is not as divorced from Production Area shippers as Golden Spread suggests. Permian Basin shippers have the ability to ship gas from the San Juan Basin or California border on a segmented or alternate point basis. Third, the purpose of the critical condition hourly scheduling penalty is to deter shipper behavior that could impair system reliability during a critical operating condition. "The Commission has recognized that setting penalties is 'not a matter for scientific calculation. Penalty charges are not cost-based, and their essential purpose is to deter undesirable shipper behavior.'"[190] In this case, El Paso is using its penalty to deter harmful scheduling activity during critical conditions. Accordingly, Golden Spread's attempt to have El Paso justify the penalty on a cost basis is inapt here. Therefore, we deny rehearing on this point.

H. Overrun Rates for Non-Telemetered Quantities

1. El Paso's Proposal

135. In its June 30 Filing, El Paso proposed to revise its tariff to provide that, to the extent a daily unauthorized overrun quantity contains non-telemetered quantities due to the lack of real-time measurement equipment, such quantities shall be assessed at the lower authorized overrun rate. El Paso states that this will minimize the shipper's exposure to penalty rates when overrunning its daily contract quantity using non-telemetered meters.[191]

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[190] *Algonquin Gas Transmission, LLC*, 115 FERC ¶ 61,067, at P 16 (2006) (citing *Northern Natural Gas Co.*, 77 FERC ¶ 61,282, at 62,235-37 (1996), *reh'g denied*, 78 FERC ¶ 61,355, at 62,494 (1997); *Trunkline Gas Co.*, Opinion No. 441, 90 FERC ¶ 61,017, at 61,078 (2000)).

[191] December 18 Order, 125 FERC ¶ 61,309 at P 100.

2. December 18 Order

136. In the December 18 Order, the Commission accepted El Paso's proposal.[192] The Commission noted its earlier rejections of pipelines' efforts to assess penalties at points with no daily or hourly metering due to shippers' inability to track the activity at those points.[193] However, the Commission found that El Paso was not attempting to impose an improper penalty on activity at non-telemetered points, but instead was proposing to charge shippers using non-telemetered points the authorized overrun rate when they overrun their gas quantities. The Commission supported its decision by explaining that unlike the unauthorized overrun rate, the authorized overrun rate does not include a penalty component.[194]

3. Requests for Rehearing

137. In its rehearing request, PNM states that while the Commission's approval of El Paso's proposal is a step in the right direction, the Commission did not go far enough in remedying the currently unjust and unreasonable assessment of daily and hourly penalties to shippers based on their activity at non-telemetered points.[195] PNM states that by failing to adjust penalty calculations to exclude hourly and daily activity that is attributed to non-telemetered points, El Paso's tariff conflicts with general Commission policy and is unjust and unreasonable. PNM proposes that the Commission require El Paso to establish a single principle in its tariff that adjusts penalty calculations to exclude flow data attributed to non-telemetered points in all instances where inclusion of such data would cause a penalty to be assessed or increased.[196]

138. PNM argues that in an earlier El Paso rate case, the Commission addressed the issue of maximum delivery obligation (MDO)/maximum hourly obligation (MHO) penalty exposure at non-telemetered points, stating that "[i]t is unjust and unreasonable for a pipeline to assess daily or hourly charges at delivery points that lack equipment to

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[192] *Id.* P 105.

[193] *Id.* (citing *Northern Natural Gas Co.*, 72 FERC ¶ 61,051, at 61,292 (1995); *Williams Natural Gas Co.*, 62 FERC ¶ 61,261, at 62,757 (1993), *order on reh'g*, 64 FERC ¶ 61,165, at 62,416 (1993)).

[194] *Id.*

[195] PNM, Request for Rehearing at 2-3.

[196] *Id.* at 4.

measure on a daily or hourly basis."[197] PNM points out that although the Commission referenced this decision in the December 18 Order, it made no attempt to address PNM's objections to El Paso's continued assessment of daily and hourly penalties (other than the daily overrun penalty) based on non-telemetered volumes. PNM states that the Commission failed to address El Paso's SOC/COC daily variance penalties and its hourly scheduling penalties, both of which are assessed at the D-Code[198] level and include, in part, activity at non-telemetered points. PNM argues that the Commission should have responded favorably to its showings on this issue and directed El Paso to make conforming tariff changes.

139. PNM further points to instances in which it received penalties based on activity at meters for which no hourly or daily measurement data is kept, and as a result, for which it had no notice that its takes might be causing it to incur penalties.[199] PNM contends that it is unjust and unreasonable to penalize shippers for activity they cannot control and that the pipeline cannot even know with certainty actually occurred.

140. PNM contends that it has met its burden under section 5 of the NGA to show that El Paso's existing tariff is unjust and unreasonable. PNM proposes tariff language that it contends will protect shippers against unfair penalty assessment while at the same time giving El Paso the discretion to implement necessary changes in a practical manner. PNM's proposed tariff language is:

> Daily and hourly penalties shall be adjusted to reflect the exclusion of flow data associated with meters that do not have active telemetry capability (temporary outages excepted) into the VISA system on a real time basis in all instances where the inclusion of such data would cause a penalty to be assessed or increased.[200]

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[197] *Id.* at 6 (quoting *El Paso Natural Gas Co.*, 121 FERC ¶ 61,266, at P 66 (2007)).

[198] A "D-Code" is an identifier used to describe an area on El Paso's system where gas is to be delivered. D-Codes were created to allow the aggregation of multiple physical delivery meters serving small loads within a specific geographic area. *See El Paso Natural Gas Co.*, 121 FERC ¶ 61,266, at P 18 & n.17 (2007).

[199] *Id.* at 7-8.

[200] *Id.* P 4.

141. PNM argues that this language recognizes two concerns: 1) there may be penalties in addition to the SOC/COC penalties and hourly scheduling penalties noted here that unfairly penalize non-telemetered point shippers; and 2) the complexity of El Paso's penalty calculation protocols makes it difficult to propose tariff changes that are unique to each penalty.[201] PNM contends that its proposed language is just and reasonable and will ensure no recurrence of the problem as the pipeline continues to modify its penalty structure. Furthermore, PNM emphasizes that its proposal is limited to the penalty portion of the hourly scheduling penalty, SOC/COC penalty or other penalties at non-telemetered points. Accordingly, PNM does not contest the Commission's finding that elimination of the penalty portion of the overrun charge for service at non-telemetered points is just and reasonable, even though the authorized overrun rate still technically exposes a customer to charges for service that it did not take in light of the averaging method used by the pipeline at non-telemetered points.[202]

4. Commission Determination

142. We deny PNM's request for rehearing of the December 18 Order and affirm our determination not to expand the scope of the instant proceeding and require El Paso to revise its tariff in the manner suggested by PNM. PNM has not met its burden to show that El Paso's existing tariff is unjust and unreasonable.

143. PNM contends that by including shipper activity at non-telemetered points in the calculation of certain penalties, El Paso's tariff is unjust and unreasonable. We disagree. PNM's objections pertain to penalties that are assessed at the D-Code level—namely, SOC/COC daily variance penalties and hourly scheduling penalties.[203] Penalties assessed at the D-Code level are assessed on aggregated shipper activity "behind" the D-Code, which includes a number of meters, some of which are equipped with telemetry and some of which are not. Therefore, it is not the case that El Paso is penalizing shipper activity based solely on activity at a non-telemetered point. Rather, SOC/COC daily variance penalty amounts and hourly scheduling penalty amounts are based on the aggregation of the shipper's activity at a number of points behind the D-Code. The aggregation of delivery points allows shippers to avoid penalties at the individual meter level. Moreover, as El Paso explained in its comments on the technical conference, the total meter delivery capability at non-telemetered points tends to be small and below the 2,000 Dth/day tolerance level within which shippers are not penalized. Therefore,

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[201] *Id.* at 9.

[202] *Id.* at 10.

[203] PNM, Request for Rehearing at 6-7.

because these penalties are imposed at the D-Code level, where shippers receive the benefit of aggregation as well as tolerance levels before incurring penalties,[204] we decline to find that PNM has shown that El Paso's existing tariff is unjust and unreasonable.

144. For support, PNM cites to an earlier *El Paso* order, in which the Commission found "[i]t is unjust and unreasonable for a pipeline to assess daily or hourly charges at delivery points that lack equipment to measure on a daily or hourly basis."[205] However, this statement must be read in light of the facts of the case in which it was made. There, the issue was whether El Paso should be able to apply the hourly usage profile of metered points to unmetered points within a D-Code and apply MHO penalties at those individual unmetered points without the benefit of aggregating all points behind the D-Code.[206] Here, however, variances at non-telemetered points make up only a part of a shipper's overall D-Code variance. Therefore, we will not extend the holding in the previous El Paso case to the present situation.

145. Because PNM has not persuaded us that El Paso's existing tariff is unjust and unreasonable, we exercise our discretion to decline to pursue any further action under section 5 of the NGA.[207]

I. Maximum Delivery Obligation and Maximum Hourly Obligation Penalties and Critical Condition Declarations on Laterals

1. El Paso's Proposal

146. In its June 30 Filing, El Paso stated that after studying whether its system requires the application of MDO and MHO penalties in non-critical conditions, it concluded that enough flexibility may exist in its mainline system to suspend the use of MDO/MHO

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[204] *See Northern Natural Gas Co.*, 101 FERC ¶ 61,203, at PP 69-71, 171 (2002) (allowing a pipeline to impose penalties notwithstanding the lack of real time data where the pipeline offered tolerance levels within which penalties would not be imposed as well as other imbalance management services).

[205] PNM, Request for Rehearing at 6 (quoting *El Paso Natural Gas Co.*, 121 FERC ¶ 61,266, at P 66 (2007)).

[206] *El Paso*, 121 FERC ¶ 61,266 at PP 62-66.

[207] *General Motors Corp v. FERC*, 613 F.2d 939, 944 (D.C. Cir. 1979); *Southern Union Gas Co*., 840 F.2d 964, 968 (D.C. Cir. 1988).

penalties in non-critical conditions on a trial basis.[208] However, El Paso explained that because laterals consist of smaller diameter and lower pressure pipelines, the same flexibility does not exist on its lateral distribution system. El Paso therefore proposed a new COC declaration provision that would allow a critical condition to be declared if necessary to protect the operational integrity of a delivery lateral. El Paso stated that so long as the new COC provision for laterals is implemented, El Paso will, on a limited trial basis, charge a zero rate for all MDO/MHO penalties that occur during non-critical operating conditions.

147. Shippers generally supported removal of the MDO/MHO penalty provision, but they argued that a proposed lateral COC declaration would be unnecessary because El Paso already has the authority to make such a declaration under section 33.2 of its General Terms and Conditions (GT&C), which requires El Paso to take all steps necessary for declaring a shipper-specific COC prior to calling a lateral or system-wide COC.[209] Shippers also argued that El Paso generally failed to exercise its authority properly, as it typically called system-wide SOC/COCs rather than targeting shipper-specific COCs. Shippers expressed concern that El Paso's proposed tariff provision would encourage El Paso to issue blanket SOC/COC declarations rather than the shipper-specific declarations required by section 33.2 of its GT&C.[210]

148. In response to these concerns, El Paso offered to withdraw its proposed lateral COC provision so long as the Commission affirms that El Paso is authorized under section 33.2(e) of its GT&C to declare an immediate emergency COC on a delivery later under specified circumstances.[211]

2. <u>December 18 Order</u>

149. In the December 18 Order, the Commission noted that El Paso agreed to withdraw its proposed lateral COC tariff language, upon the Commission affirming its understanding of section 33.2(e) of its GT&C.[212] In response, the Commission found that it is important for El Paso to have the authority to declare a critical operating condition on a delivery lateral in order to ensure system integrity and service reliability. However, the

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[208] December 18 Order, 125 FERC ¶ 61,309 at P 43.

[209] *Id*. P 44.

[210] *Id*. P 45.

[211] *Id*. P 47.

[212] *Id*. P 48.

Commission explained that equally important was the need for El Paso to minimize the impact of COC declarations on shippers by targeting these declarations to the fewest shippers feasible.[213] The Commission noted that shippers do not dispute that pursuant to section 33.2 of El Paso's GT&C, El Paso already has the authority to declare immediate critical operating conditions on laterals if it determines that it is unable to call a more limited shipper-specific critical operating condition. Accordingly, the Commission accepted El Paso's interpretation of section 33.2(e) of its GT&C. The Commission also accepted El Paso's proposal to eliminate MDO/MHO penalties in non-critical conditions for the trial period, as well as El Paso's offer to monitor and report delivery point operator activities throughout the trial period to determine whether non-critical MDO/MHO penalties would be necessary in the future.[214]

3. Request for Clarification

150. In its request for clarification, Salt River reiterates the concerns it and other shippers raised in response to the technical conference. Salt River points out that it requested that the Commission instruct El Paso to more diligently monitor operating conditions and focus SOC/COC declarations on those shippers who are the source of the threat to system integrity and to require El Paso to demonstrate to the Commission that it took all reasonable and necessary steps to identify specific shippers prior to calling the critical operating condition on a lateral or system-wide basis.[215] Salt River states that while the Commission recognized its concerns in the December 18 Order, the order was silent on whether El Paso is required to make electronic bulletin board (EBB) postings that demonstrate compliance when declaring a COC on a delivery lateral, i.e., that it took all reasonable and necessary measures to determine that it was unable to call a more limited shipper specific COC instead. Salt River requests that to the extent El Paso does not clarify its EBB posting provisions in this manner *sua sponte*, that the Commission require El Paso to do so.[216]

4. Commission Determination

151. We will deny Salt River's request for rehearing on this point. El Paso's tariff provides that El Paso will post a full explanation of the relevant operational facts and

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[213] *Id.* (citing Order No. 637, FERC Stats. & Regs. ¶ 31,091 at 31,312).

[214] *Id.* P 49.

[215] Salt River, Request for Clarification at 2.

[216] *Id.* at 3-4.

circumstances pertaining to El Paso's calling of a critical operating condition, as well as the steps its has taken. We therefore find Salt River's requested reporting requirements specific to critical operating conditions on laterals to be redundant. We reiterate our finding in the December 18 Order, that El Paso is required to minimize the impact of COC declarations on shippers by targeting COCs to the fewest shippers feasible, consistent with Order No. 637.[217] Salt River has not provided evidence to indicate that El Paso is not complying with this mandate. Accordingly, we deny its request for rehearing on this point.

The Commission orders:

(A) Requests for rehearing and/or clarification are granted, in part, and denied, in part, consistent with the above discussion.

(B) El Paso is directed to file revised tariff records consistent with this order within thirty (30) days of the date this order issues.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

[217] December 18 Order, 125 FERC ¶ 61,309 at P 48.