145 FERC ¶ 61,040
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

El Paso Natural Gas Company | Docket No. RP10-1398-000

OPINION NO. 528

OPINION AND ORDER ON INITIAL DECISION

Issued: (Issued October 17, 2013)

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

El Paso Natural Gas Company Docket No. RP10-1398-000

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145 FERC ¶ 61,040
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

El Paso Natural Gas Company | Docket No. RP10-1398-000

OPINION NO. 528

OPINION AND ORDER ON INITIAL DECISION

(Issued October 17, 2013)

1. This order addresses briefs on and opposing exceptions to an Initial Decision issued on June 18, 2012, by the presiding Administrative Law Judge (Presiding Judge) in the above-captioned proceeding.[1] The Initial Decision set forth the Presiding Judge's findings concerning the issues reserved for hearing in a general rate case filed by El Paso Natural Gas Company (El Paso) pursuant to section 4 of the Natural Gas Act (NGA) on October 28, 2010 (2011 Rate Case).[2]

2. As discussed below, the Commission affirms in part and modifies in part the Initial Decision. The Commission finds, among other things, that El Paso's return on equity should be at the median of the proxy group (at 10.55 percent) because its risk does not reflect highly unusual circumstances; rejects continued challenges to the 1996 Settlement and upholds the Article 11.2 rate caps; finds that El Paso has failed to meet the requirements of Article 11.2(b) and remands the issue of the appropriate remedy to the Office of Administrative Law Judges for a supplemental hearing; finds that El Paso's proposed successor-in-interest procedures are just and reasonable; and finds that El Paso must exclude costs related to the abandoned Tucson and Deming Compressor Stations from its cost of service.

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[1] Appendix A lists the Briefs on and Opposing Exceptions, showing the Participants joining each Brief along with the designations used in this opinion.

[2] *El Paso Natural Gas Co.*, 139 FERC ¶ 63,020 (2012) (ID or Initial Decision). While this case was pending, Kinder Morgan, Inc. acquired El Paso's parent, El Paso Corp., effective May 25, 2012. Thereafter on August 1, 2012, El Paso became a limited liability company and changed its name to El Paso Natural Gas Company, L.L.C.

I. Background

3. 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 natural 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 natural 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.

4. The issues addressed in this hearing relate to events on El Paso's system dating back over twenty years. Provided below is a brief summary of these major events.[3]

A. 1990 Settlement

5. In 1990, El Paso entered into a settlement (1990 Settlement) with its customers that, among other things, implemented contract conversions from bundled sales service to transportation service. At that time, El Paso's practice was to serve its firm customers under two types of contracts: full requirements contracts and contract demand (CD) contracts. Contract demand contracts provided specific delivery rights up to a specified quantity limitation at delivery points designated in the contracts. Full requirements contracts provided that El Paso deliver the customer's full gas requirements each day. There was no limit on the amount of gas the full requirements shippers could require El Paso to transport, other than the capacity of their delivery points. The contract demand contracts on El Paso were held mainly by California customers, while the full requirements contracts were held mainly by customers located east of California. The 1990 Settlement specifically provided for the continuation of full requirements service on the El Paso system. The 1990 Settlement also provided for *pro rata* allocations of capacity among firm shippers.

B. 1996 Settlement

6. In 1996, El Paso entered into another settlement that resolved capacity-turnback issues on El Paso and set rates and terms of service for a ten-year period (1996

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[3] *See also* ID, 139 FERC ¶ 63,020 at PP 3-14.

Settlement). At the time the Commission approved the 1996 Settlement,[4] there was substantial excess capacity on El Paso's system. Following the restructuring and unbundling of the natural gas industry in the 1990s, the California local distribution company customers turned back their rights to capacity on El Paso at the request of the California Public Utilities Commission (CPUC). As a result, approximately 35 percent of the capacity on the El Paso system became unsubscribed. This excess capacity threatened to increase the rates of the remaining El Paso customers. The 1996 Settlement resolved this issue through an agreed-upon sharing of both the risk of the unsubscribed capacity and the revenues realized when El Paso resold the turnback capacity.

7. The 1996 Settlement also established a rate cap for certain shippers. Specifically, Article 11.2(a) of the 1996 Settlement provided that rates for capacity then under contract by eligible shippers would be capped, subject to inflation, and that the rate cap would continue to apply until the termination of shippers' transportation service agreements (TSA).[5] Article 11.2(b) provided that even if eligible shippers entered into new service

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[4] El Paso filing of conforming changes to stipulation and agreement, Docket No. RP95-363-008 (June 9, 1997) (1996 Settlement). The 1996 Settlement was accepted in *El Paso Natural Gas Co*., 79 FERC ¶ 61,028, *reh'g denied*, 80 FERC ¶ 61,084 (1997).

[5] Sections (a) and (b) of Article 11.2 provide:

> 11.2 Firm TSAs In Effect on December 31, 1995, That Remain in Effect Beyond January 1, 2006. This paragraph 11.2 applies to any firm Shipper with a TSA that was in effect on December 31, 1995, and that remains in effect, in its present form or as amended, on January 1, 2006, but only for the period that such Shipper has not terminated such TSA. El Paso agrees with respect to such Shippers that, in all rate proceedings following the term of this Stipulation and Agreement:
>
> (a) Base Settlement Rate Escalated. El Paso will not propose to charge a rate applicable to service under such TSA during the remainder of the term thereof that exceeds the base settlement rate established under paragraph 3.2(a) applicable to such Shipper, as adjusted pursuant to paragraphs 3.2(b) and 3.5 through the term of this Stipulation and Agreement, as escalated annually thereafter through the remainder of the term of such TSA using the procedure specified by paragraph 3.2(b) unless and until such TSA is terminated by the Shipper.

(continued…)

agreements in the future, their rates would never include costs attributable to capacity, up to the level in existence on the El Paso system at the time of the 1996 Settlement, that becomes unsubscribed or is subscribed at less than the maximum applicable tariff rate.

C. Capacity Allocation Proceeding

8. During the initial term of the 1996 Settlement (1996-2005), circumstances on the El Paso system changed dramatically. Available capacity on El Paso went from an excess to a constrained condition.[6] Several factors contributed to this turn of events, including substantial growth in full requirements shippers' load to amounts far in excess of shippers' billing determinants. As a result, in 2000 and 2001, El Paso experienced significant capacity allocation problems that culminated in complaints filed against El Paso in two separate proceedings, known as the Capacity Allocation Proceeding[7] and the CPUC Complaint Case.[8]

> (b) Unsubscribed Capacity Costs. El Paso agrees that the firm rates applicable to service to any Shipper to which this paragraph 11.2 applies will exclude any cost, charge, surcharge, component, or add-on in any way related to the capacity of its system on December 31, 1995, to deliver gas on a forward haul basis to the Shippers listed on *Pro Forma* Tariff Sheet Nos. 33-35, that becomes unsubscribed or is subscribed at less than the maximum applicable tariff rate as escalated pursuant to paragraph 3.2(b). El Paso assumes full cost responsibility for any and all existing and future step-downs or terminations and the associated CD/billing determinants related to the capacity described in this subparagraph (b).

[6] *See generally*, *Amoco Energy Trading Co. v. El Paso Natural Gas Co.*, 93 FERC ¶ 61,060, *order on clarification*, 93 FERC ¶ 61,222 (2000), *order on reh'g*, 94 FERC ¶ 61,225 (2001) (*Topock*) (directing El Paso to file proposal to allocate receipt point capacity).

[7] *El Paso Natural Gas Co.*, 99 FERC ¶ 61,244 (addressing El Paso's capacity allocation filing, as well as complaints filed by California parties and east of California full requirements shippers) (*Capacity Allocation Complaint Order*), *clarified*, 100 FERC ¶ 61,285 (2002) (*Capacity Allocation Clarification Order*), *reh'g and clarification granted in part*, 104 FERC ¶ 61,045 (2003) (*Capacity Allocation Rehearing*), *reh'g granted in part*, 106 FERC ¶ 61,233 (2004), *petition for review denied*, *Arizona Corp. Comm'n v. FERC*, 397 F.3d 952 (D.C. Cir. 2005) (*ACC*), *voluntary remand on other*

(continued…)

9. In the Capacity Allocation Proceeding, the Commission agreed with the complainants that the quality of firm service on the El Paso system had deteriorated and would continue to deteriorate without Commission action.[9] The Commission found that the then-current allocation methodology on El Paso, with *pro rata* allocations of firm service when El Paso had insufficient capacity to serve all of its firm customers, was not just and reasonable or in the public interest. Accordingly, the Commission established a framework for resolving the complicated capacity allocation problems that disrupted and degraded firm service on El Paso. Specifically, the Commission directed El Paso to convert its full requirements contracts to contract demand contracts with specific demand limits up to El Paso's available capacity, so that service to one firm shipper would not adversely affect firm service to others. The Commission set forth the method for converting the full requirements contracts. After reserving the amount of capacity necessary to meet the needs of the existing contract demand shippers, the Commission allocated to the former full requirements shippers, as part of their new contract demands, all of the remaining available capacity as well as expansion capacity related to the Line 2000 and Power-Up expansion projects.

10. In the Capacity Allocation Proceeding, the Commission found that to convert full requirements service to contract demand service, it was necessary and in the public interest to modify portions of the 1996 Settlement. However, the Commission also found that the 1996 Settlement should only be modified to the extent necessary to restore reliable firm service on El Paso, and that the remainder of the 1996 Settlement should remain in effect until its expiration. The Commission did not specifically modify Article 11.2 of the 1996 Settlement.

D. <u>2006 Rate Case and Settlement</u>

11. On June 30, 2005, in Docket No. RP05-422-000, El Paso filed a general NGA section 4 system-wide rate case, which modified rates, proposed a number of new services, and revised a number of terms and conditions of its tariff (2006 Rate Case). The 2006 Rate Case constituted El Paso's first general rate case in ten years, following the 1996 Settlement. In its 2006 Rate Case, El Paso, among other things, requested that the

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issues, 115 FERC ¶ 61,259 (2006), *reh'g denied*, 120 FERC ¶ 61,170 (2007) (collectively the Capacity Allocation Proceeding or CAP).

[8] *Public Utilities Comm. of the State of California v. El Paso Natural Gas Co.*, 94 FERC ¶ 61,338 (providing for hearing on market power issues), *reh'g granted in part*, 95 FERC ¶ 61,368 (2001) (expanding hearing to include affiliate issues), *order approving contested settlement*, 105 FERC ¶ 61,201 (2003).

[9] *Capacity Allocation Complaint Order*, 99 FERC at 62,199-200.

Commission find that the rate protections provided to certain shippers under Article 11 of El Paso's 1996 Settlement no longer applied and that any obligations that El Paso or any other settling party had under Article 11 had been permanently extinguished and fully discharged as a result of the Capacity Allocation Proceedings. On July 29, 2005, the Commission issued an order accepting and suspending the proposed tariff sheets, subject to refund and conditions, and establishing hearing procedures and a technical conference. In the *2006 Rate Case Suspension Order*, the Commission stated that issues related to the continued applicability of Article 11 would be addressed after the technical conference.[10] Following the technical conference, the Commission issued its *March 20 Order*, which determined that the Article 11.2 rate caps and other rate provisions would continue to apply to certain eligible shippers beyond the termination of the 1996 Settlement.[11] The Commission issued a second order addressing issues discussed at the technical conference concerning the implementation of new services on March 23, 2007, which was upheld on rehearing on December 20, 2007.[12]

12. On December 6, 2006, El Paso submitted a settlement agreement, which the Commission subsequently approved on August 31, 2007 (2006 Rate Case Settlement).[13] The 2006 Rate Case Settlement, which terminated on December 31, 2008, required El Paso to file a new general rate case on June 30, 2008, to be effective on January 1, 2009.

13. On January 17, 2012, the United States Court of Appeals for the District of Columbia Circuit (D.C. Circuit Court) reviewed seven Commission orders issued in the

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[10] *El Paso Natural Gas Co.*, 112 FERC ¶ 61,150 (2005) (*2006 Rate Case Suspension Order*), *reh'g denied*, 116 FERC ¶ 61,016 (2006) (solely addressing culpability issues), *aff'd sub nom.*, *Freeport-McMoRan Corp. v. FERC*, 669 F.3d 302 (D.C. Cir. 2012) (*Freeport*).

[11] *El Paso Natural Gas Co.*, Order on Post [1996] Settlement Issues, 114 FERC ¶ 61,290 (2006) (*March 20 Order*), *reh'g denied*, 124 FERC ¶ 61,227 (2008) (*September 5 Order*), *reh'g denied*, 132 FERC ¶ 61,155 (2010) (*August 24 Rehearing Order*), *aff'd*, *Freeport*, 669 F.3d 302.

[12] *El Paso Natural Gas Co.*, Order on Technical Conference, 114 FERC ¶ 61,305 (2006) (*March 23, 2006 Order*), *reh'g denied*, 121 FERC ¶ 61,266 (2007) (addressing issues not resolved in 2006 Rate Case Settlement) (*December 20, 2007 Order*), *order granting partial rehearing and addressing compliance issues*, 123 FERC ¶ 61,258 (2008) (addressing shippers maximum delivery obligations and maximum hourly obligations).

[13] *El Paso Natural Gas Co.*, 120 FERC ¶ 61,208 (2007) (*2006 Rate Case Settlement Order*), *reh'g denied*, 132 FERC ¶ 61,139, *clarified*, 133 FERC ¶ 61,116 (2010).

2006 Rate Case proceedings in Docket No. RP05-422, *et al.*, and affirmed the Commission's holdings in *Freeport*.[14] In *Freeport*, the D.C. Circuit Court affirmed the Commission's determination that the Article 11.2 rate cap remained in effect and rejected arguments from El Paso that the Commission had applied Article 11.2 too broadly by holding that the rate cap continued to apply to the former full requirements shippers' CD contracts. Separately, the D.C. Circuit Court rejected arguments from Freeport McMoRan Corp. that the Commission had applied Article 11.2 too narrowly by failing to hold that it applied to expansion capacity. The court also held that the Commission had reasonably adopted the presumption that the capacity of El Paso's system on December 31, 1995 was 4,000 MMcf/d.[15]

E. <u>2008 Rate Case</u>

14. On June 30, 2008 in Docket No. RP08-426-000, El Paso made the general NGA section 4 rate case filing required by the 2006 Rate Case Settlement (2008 Rate Case). El Paso proposed to increase its base transportation rates by 25 percent over its previously effective rates, to institute a new service, and to change certain terms and conditions of service. The filing included both primary tariff records, which continued the operation of rate caps established pursuant to Article 11.2 of the 1996 Settlement, and alternate tariff sheets, which assumed the termination of the rate caps. El Paso also proposed short-term firm and interruptible rates capped at 250 percent of the related long-term recourse rate. El Paso proposed an effective date of January 1, 2009, as required by the 2006 Rate Case Settlement. The Commission rejected El Paso's alternate tariff records, accepted and suspended El Paso's primary tariff sheets, to become effective on January 1, 2009, subject to refund and conditions, and established procedures for a technical conference and an evidentiary hearing.[16]

15. On March 13, 2010, El Paso filed an uncontested settlement on the majority of the issues in the 2008 Rate Case, with four issues reserved for hearing (2008 Rate Case

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[14] *Freeport*, 669 F.3d 302.

[15] MMcf = million cubic feet. Based on El Paso's system conversion factor, 1 MMcf of gas equates to 1.017 dekatherms (Dth), with 1 Dth equaling 1 million British thermal units (Btu).

[16] *El Paso Natural Gas Co.*, 124 FERC ¶ 61,124 (2008) (*2008 Rate Case Suspension Order*), *reh'g denied*, 133 FERC ¶ 61,129 (2010) (*November 10 Rehearing Order*), *clarification and rehearing dismissed as moot*, 134 FERC ¶ 61,170 (2011). The technical conference issues were addressed in *El Paso Natural Gas Co.*, 125 FERC ¶ 61,309 (2008).

Settlement).[17] The four issues reserved for hearing were: (1) the amount to be included in El Paso's capital account for ratemaking and accounting purposes related to Line 1903; (2) the appropriate capital structure; (3) the appropriate rate design for the maximum recourse rate for interruptible transportation service (IT), interruptible parking and lending service (PAL), and short-term firm transportation rates; and (4) issues related to Article 11.2 of the 1996 Settlement. The 2008 Rate Case Settlement provided that the resolution of the issues relating to capital structure and Line 1903 would not affect the settlement rates or revenues during the term of the settlement; consequently, the holdings on those issues apply in this rate case.

16. The hearing on the four reserved issues commenced on May 18, 2010 and concluded on June 8, 2010. The Presiding Judge issued an Initial Decision on January 14, 2011.[18] The Presiding Judge made the following findings on the four issues: (1) El Paso's proposal to roll-in and recover in its cost of service the $36.2 million price of Line 1903 was unjust and unreasonable; (2) El Paso's proposed capital structure of 39.2 percent debt and 60.8 percent equity was not just and reasonable because the equity component of El Paso's capital structure included $145,307,340 of undistributed subsidiary earnings and $615,456,458 related to a Cash Management Program; (3) El Paso's short-term and interruptible rate design proposal did not comport with Commission policy and was therefore not just and reasonable; and (4) the Article 11.2 rate caps of the 1996 Settlement remain in effect, are just and reasonable, and should not be eliminated under the *Mobile-Sierra* public interest standard in light of changes to the El Paso system;[19] (5) El Paso should not be allowed to reallocate the alleged revenue shortfall caused by the rate cap to other customers; (6) El Paso failed to meet the 4,000 MMcf/d subscription presumption and must implement the Article 11.2(b) rate adjustment; and (7) a shipper that acquires or retains a small Article 11.2 contract is entitled to the benefit of the Article 11.2(b) rate adjustment for all its load.

17. The Commission issued an Opinion and Order on Initial Decision on May 4, 2012.[20] In Opinion No. 517, the Commission affirmed and adopted the 2008 Rate Case

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[17] Accepted in *El Paso Natural Gas Co.*, 131 FERC ¶ 61,077 (2010) (letter order) (*2008 Rate Case Settlement Order*).

[18] *El Paso Natural Gas Co.*, Initial Decision, 134 FERC ¶ 63,002 (2011) (2008 Rate Case Initial Decision).

[19] *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956) (*Mobile*); *Federal Power Comm'n v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956) (*Sierra*).

[20] *El Paso Natural Gas Co.*, Opinion No. 517, 139 FERC ¶ 61,095 (2012).

Initial Decision on the bulk of the rulings on the four issues reserved for hearing. However, with respect to the subsidiary issue related to Article 11.2(b), the Commission reversed the Presiding Judge's determination that El Paso failed to meet the 4,000 MMcf/d presumption and found that no additional rate adjustment under Article 11.2(b) was required.

F. <u>Fuel Complaint Case</u>

18. On July 7, 2010, Texas Gas Service Company, a Division of ONEOK, Inc. (Texas Gas Service) filed a complaint in Docket No. RP10-951-000 challenging the collection of fuel costs by El Paso on a postage stamp basis (Fuel Complaint Case).[21] Texas Gas Service argued that the collection of fuel costs on a postage stamp basis is unjust and unreasonable because it fails to reflect distance of haul and therefore results in an improper cross-subsidy among El Paso's shippers. Texas Gas Service contended that recovering fuel costs by zone based on actual miles of haul would be a just and reasonable alternative.

19. On October 22, 2010, the Commission issued an order setting the issues for hearing. In an Initial Decision issued September 7, 2011, the Presiding Judge found that the record did not support the position that the El Paso postage stamp fuel rate is unjust and unreasonable. On November 15, 2012, the Commission issued an Order on Initial Decision, affirming and adopting the Initial Decision.[22]

G. <u>Current Proceeding (2011 Rate Case)</u>

20. On September 30, 2010, El Paso filed a general NGA section 4 rate case (2011 Rate Case) in Docket No. RP10-1398-000 in which it proposed a rate increase for existing services and changes to certain terms and conditions of service. El Paso filed both primary and alternate tariff records with an effective date of November 1, 2010. The Commission (1) accepted the proposed primary tariff records subject to refund, hearing, and the outcome of the 2006 Rate Case, 2008 Rate Case, and Fuel Complaint

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[21] *Texas Gas Service Co., a Division of ONEOK Inc. v. El Paso Natural Gas Co.*, 133 FERC ¶ 61,079 (2010), Initial Decision, 136 FERC ¶ 63,010 (2011), Order on Initial Decision, 141 FERC ¶ 61,130 (2012), *order on reh'g*, 143 FERC ¶ 61,200 (2013) (collectively, Fuel Complaint Case).

[22] Fuel Complaint Case, Order on Initial Decision, 141 FERC ¶ 61,130.

Case proceedings; (2) rejected the alternate tariff records; and (3) suspended the effectiveness of the proposed rate increase and other tariff records until April 1, 2011.[23]

21. In an order on rehearing of the *2011 Rate Case Suspension Order,* the Commission stated that the purpose of making the 2011 Rate Case filing subject to the outcome of the 2008 Rate Case proceeding was, in part, to "give the Commission the opportunity to make its decision based on a completed hearing record."[24] Moreover, "[b]y accepting the primary tariff records and maintaining the status quo of the Article 11.2 rate protections, the Commission's intent is to prevent re-litigation of identical issues in this rate case prior to a final determination on these Article 11.2 issues in the [2008 Rate Case] rate proceeding."[25] The Commission held that "Article 11.2 contract issues [would] be eligible for litigation in this case [the 2011 Rate Case] only to the extent that they were not finally decided in [the 2008 Rate Case]."[26] The Commission also held that the issue of the duration of Article 11.2 contracts is not an issue in the 2011 Rate Case.[27]

22. The hearing was conducted from October 25, 2011 through December 14, 2011. The hearing addressed the issues identified by the parties in the October 24, 2011 Revised Joint Stipulation of Contested Issues (Joint Stipulation).[28]

II. Summary

23. The Commission affirms in part and reverses in part the Initial Decision, which sets forth the Presiding Judge's findings under the NGA on the issues reserved for hearing in the *2011 Rate Case Suspension Order* on October 28, 2010 on El Paso's 2011 Rate Case filing. The instant Order on Initial Decision includes the following determinations:

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[23] *El Paso Natural Gas Co.*, 133 FERC ¶ 61,104 (*2011 Rate Case Suspension Order*), *order on reh'g and clarification,* 133 FERC ¶ 61,253 (2010) (*2011 Rate Case Suspension Rehearing*).

[24] *2011 Rate Case Suspension Rehearing,* 133 FERC ¶ 61,253 at P 16.

[25] *Id.*

[26] *Id.* P 14.

[27] *Id.* P 12.

[28] This Opinion cross references the numbered issues in the Joint Stipulation.

(a) Cost of Service: (1) affirms the Presiding Judge's determinations rejecting the use of gas supply expense projections, (2) reverses the holding permitting El Paso to book pension costs based on an actuarial study when no payments were made or accrued in the test period, (3) affirms the determination establishing compressor overhaul costs, and (4) reverses the Presiding Judge's ruling on rate case expenses, finding that the three-year average rate case expense is the appropriate amount;

(b) Depreciation and Negative Salvage: (1) affirms the ruling establishing a negative salvage rate of 0.12 percent, (2) affirms the rejection of El Paso's proposal to establish a range of depreciation rates, (3) reverses the ruling on use of contract life to establish depreciation for the Willcox lateral facility, and (4) affirms the rulings establishing depreciation rates for general and intangible plant;

(c) Rate Base: (1) affirms the determinations on rate base reductions reflecting Medicare subsidies, (2) reverses the finding that, because El Paso failed to provide adequate documentation for ADIT and depreciation accounting adjustments in a prior proceeding, the adjustments similarly could not be established in this proceeding, and (3) affirms the finding requiring El Paso to exclude costs related to the abandoned Tucson and Deming Compressor Stations from its cost of service;

(d) Billing Determinants: affirms the use of end-of-test period billing determinants and decision to decline to normalize the prior year volumes for a cold-weather incident;

(e) Cost Allocation and Rate Design: affirms (1) approval of El Paso's zone of delivery/contract path methodology, with the modification discussed below, (2) rejection of shippers' proposed postage-stamp rates, (3) rejection of El Paso's proposal to equalize rates in California and bordering sates, (4) approval of variable cost allocation and various holdings on hourly and premium service rates, (5) rejection of the "within basin" production zone rate methodology, and (6) rejection of shippers' proposed automatic daily balancing provisions; however, the order reverses the Presiding Judge to find that El Paso should follow the Commission's policy that cost allocation should be based on unadjusted billing determinants;

(f) Risk/Cost Sharing: affirms (1) approval of El Paso's discount adjustment, (2) rejection of a cost-sharing for unsubscribed capacity, and (3) finding El Paso's Phase III Power-Up project construction expenses were appropriate;

(g) Capital Structure: affirms the findings on Capital Structure in the 2008 Rate Case;[29]

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[29] As discussed below, El Paso requested rehearing of the Commission's determination that a loan to its parent should be deducted from its equity capitalization.

(h) Return on Equity: (1) affirms the Presiding Judge's proxy group selection, (2) affirms the Presiding Judge's rejection of El Paso's changes to the Commission's discounted cash flow (DCF) methodology, and (3) reverses the finding that El Paso should be placed well above the median return on equity (ROE);

(i) Tariff Changes: (1) affirms the ruling that El Paso's proposed limitation on the addition of meters to a D-Code is vague and overbroad, (2) affirms the finding that El Paso's proposed limitation to contract assignments is not just and reasonable, and (3) affirms rejection of shippers' proposed automatic waiver of penalties during *force majeure*; and

(j) Article 11.2 of the 1996 Settlement: (1) affirms the findings that Article 11.2 remains in effect consistent with the public interest, (2) affirms that El Paso may not reallocate shortfalls under the 1996 Settlement to non-settlement recourse customers, (3) finds that El Paso's proposed bifurcated cost of service is not just and reasonable, (4) reverses the Presiding Judge's finding that El Paso has met a 4,000 MMcf/d threshold to demonstrate that Article 11.2(b) rate protections were not triggered and remands the issue for determination of the appropriate remedy, and (5) affirms the finding that El Paso's proposed successor-in-interest procedures are just and reasonable.

24. Because the Commission finds that El Paso failed to demonstrate that it satisfied the requirements of Article 11.2(b) of the 1996 Settlement, it is necessary to determine an appropriate means to ensure compliance with that article. The Commission finds that there is an insufficient record to determine an appropriate remedy and therefore remands this issue to the Office of Administrative Law Judges for a Supplemental Hearing to determine the extent to which El Paso may be recovering costs of unsubscribed or discounted 1995 capacity through Article 11.2(b) contracts in violation of Article 11.2(b), and, if so, to develop revisions to the applicable rates to ensure that Article 11.2(a) shippers do not bear the cost of unsubscribed or discounted 1995 capacity through contracts protected by Article 11.2(b).

III. Cost of Service Issues

25. The Commission's regulations provide that, for ratemaking purposes, costs must be incurred within a test period consisting of a base period followed by an adjustment period. The Commission's regulations state:

> [T]he test period consists of a base period followed by an adjustment period . . . . The base period consists of 12 consecutive months of the most recently available *actual* experience. . . . The adjustment period is a period of up to nine months immediately following the base period. . . . The rate factors (volumes, costs, and billing determinants) established during the base period may be adjusted for

> changes in revenues and costs which are *known and measurable with reasonable accuracy* at the time of the filing and which will become effective within the adjustment period. The base period factors must be adjusted to eliminate nonrecurring items. The company may adjust its base period factors to normalize items eliminated as nonrecurring.[30]

26. On May 16, 2011, El Paso filed its 45-day update filing to adjust its test period costs to provide actual data for each month of the test period through the end of the adjustment period, March 31, 2011.[31] Where required, the updated test period filing combines the adjustment period costs with base period actual monthly costs to provide actual data for the twelve months ending March 31, 2011. Participants take exception to the Presiding Judge's determinations as to (A) Other Gas Supply expenses (Account No. 813) (Stipulated Issue III.A), (B) pension expenses (Account No. 926) (Stipulated Issue III.C), (C) Compressor Station Overhaul and Periodic Maintenance Expense (Account No. 864) (Stipulated Issue III.E), and (D) Regulatory Commission Expense (Account No. 928) (Stipulated Issue III.F), which are addressed below.

27. No party took exception to the Presiding Judge's determinations regarding El Paso's Pipeline Integrity Program (PIP) expenses (Stipulated Issue III.B) or Retirement Savings Plan expenses (i.e., El Paso's 401-K special contribution) (Stipulated Issue III.D). Consequently, the Commission summarily affirms the Presiding Judge's findings on these issues.

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[30] 18 C.F.R. § 154.303(a) (2013) (emphasis added, numbering omitted).

[31] *See* 18 C.F.R. § 154.311 (2013) (Updating of statements). No participant objected to the Presiding Judge's reliance on test period data for the twelve-month period ending March 31, 2011 to calculate El Paso's cost of service. The Presiding Judge questioned the Commission's preference for using twelve months of end of test period data, reflected in the practice to refer to such data with the shorthand reference to "test period data," noting that the regulations require only that rates be calculated based on a test period consisting of a twelve month base period, as adjusted in a 9-month adjustment period (*see* the ID discussions of compressor station overhauls and other gas expenses). However, as section 154.303 indicates, the Commission has discretion to calculate rates based on the most recent 12 months as being most representative of the types of costs likely to be incurred when the rates are effective ("rate factors . . . may be adjusted. . ."). The instant order will generally refer to data from this time period as "end of test period" data.

A. Operation and Maintenance

1. Other Gas Supply Expenses (Account No. 813) (Stipulated Issue III.A)

28. In its 2011 Rate Case filing, made September 30, 2010, El Paso projected $5,207,989 of Account No. 813, Other Gas Supply expenses, represented in its cost schedule by a $14.9 million credit or negative balance to the account for twelve months of base period activity, which was offset by a $20.1 million adjustment to the base period balance.[32] El Paso described the costs as "base period gas losses, gas-balance and other gas-related costs not otherwise recovered through any other rate mechanism," including costs attributable to timing differences and gas price changes occurring in the interim between when fuel or other imbalances are created and when they are resolved.[33] To prevent over-recovery, El Paso proposed to establish a regulatory liability in the same amount (approximately $5.2 million per year) and reflect any accumulated liability in its next general NGA section 4 rate case.

29. In its May 16, 2011 45-day update filing, El Paso reported end of test-period actual costs of $1,247,596 for Account No. 813 (Other Gas Supply) for the twelve month period ending March 31, 2011.[34] Nevertheless, in its Initial Brief filed on January 20, 2012, El Paso reasserted an annual cost of $5.2 million for its Account No. 813.[35]

30. At hearing, Trial Staff, Indicated Shippers, and SoCal Gas/San Diego objected to the higher figure, claiming that it departed from the Commission's test period regulations and that test period costs should be used.[36] Indicated Shippers and Trial Staff objected to the use of deemed costs or accounting entries in the place of actual cost data.[37] Trial Staff objected to the regulatory liability proposal as lacking a refund provision, meaning that refunds would be possible only through the ratemaking process with a significant

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[32] 2011 Rate Case, Schedule H-1(1); *see also* Ex. EPG-32 at 1.

[33] ID, 139 FERC ¶ 63,020 at P 71.

[34] 45-Day Update Filing, Schedule H-1(2)(a); *see also* Ex. EPG-34A at 2.

[35] El Paso Initial Br. at 31-33 (as corrected on January 23, 2012).

[36] Trial Staff Initial Br. at 47-49; Indicated Shippers Initial Br. at 11-12; SoCal Gas/San Diego Initial Br. at 8; ID, 139 FERC ¶ 63,020 at P 72.

[37] Indicated Shippers Initial Br. at 11-12; Trial Staff Reply Brief at 50.

delay.[38] SoCal Gas/San Diego characterized the regulatory liability proposal as a mechanism to amass ratepayer-funded reserves in violation of the Commission's test-period policy.[39]

Initial Decision

31. The Presiding Judge held that the correct amount for Account No. 813 is $1,247,596, which is the updated test period cost figure.[40] The Presiding Judge based his decision on a finding that no party could overcome the presumption that the test period costs are a just and reasonable figure. The Presiding Judge held that because the updated test period cost of $1,247,596 did not appear to reflect unverifiable or deemed costs, it was the appropriate entry for Account No. 813. The Presiding Judge rejected El Paso's $5.2 million figure as unsupported, citing El Paso's description of the higher figure as being "a *representative level* of these types of expenses [El Paso] *is likely to incur* on an on-going basis," rather than actual costs attributable to timing differences.[41]

Briefs on Exceptions

32. Indicated Shippers assert the Presiding Judge should be reversed and there should be no recovery of Account No. 813 costs because El Paso has not carried its burden of proving that the costs totaling $1,247,596 were actually incurred.[42] Indicated Shippers assert that El Paso's costs are associated with "timing differences," rather than actual incurred costs, and should be rejected.

Briefs Opposing Exceptions

33. El Paso argues that the $1,247,596 in costs is the appropriate end of test period figure because, as SoCal Gas/San Diego's Witness Fink testified, these costs were likely to be incurred on an ongoing basis, were necessary for rendering service, and were appropriate for pass-through to El Paso's customers.[43] El Paso states that the Presiding

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[38] Trial Staff Initial Br. at 48.

[39] SoCal Gas/San Diego Initial Br. at 7-8.

[40] ID, 139 FERC ¶ 63,020 at PP 75-77.

[41] ID, 139 FERC ¶ 63,020 at P 76 & n.64 (citing Ex. IS-27; Ex. EPG-231 at 32) (emphasis added).

[42] Indicated Shippers Brief on Exceptions at 16-17.

[43] El Paso Brief Opposing Exceptions at 24.

Judge properly found that these costs were verifiable. El Paso also asserts that Indicated Shippers did not cross-examine any of the witnesses who stated that it was reasonable for El Paso to include these updated test period costs in its rates and that the Presiding Judge should be affirmed.

Commission Determination

34. The Commission affirms the Presiding Judge's finding that $1,247,596 is the appropriate Account No. 813 (Other Gas Supply) expense amount. The Commission's regulations require that a pipeline's rates be based on cost data adjusted to reflect known and measurable changes that become effective in an adjustment period, consisting of the nine-month period following the base period.[44] Section 154.303(a)(4) of the Commission's regulations states that the costs a pipeline reports in its filing may be adjusted for changes which are "*known and measurable with reasonable accuracy* at the time of the filing and which will become effective within the adjustment period."[45] The Presiding Judge's finding is consistent with the Commission's test period policy, as discussed below.

35. The $1,247,596 Account No. 813 figure contained in El Paso's 45-day update filing[46] was supported by the record and was distinguishable from deemed costs that were found to be unverifiable.[47] El Paso's witness supported the updated test period cost figure as actual costs, in contrast to the earlier figure representing accounting entries for unresolved transactions based on price fluctuations. In addition, the Presiding Judge relied on the fact that other participants supported the $1.2 million figure as representing actual costs.[48] Indicated Shippers cite no evidence that El Paso's claimed costs are in error. Indicated Shippers failed to pursue cross-examination on this issue and thus failed

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[44] *See* 18 C.F.R. § 154.303 (2013).

[45] 18 C.F.R. § 154.303(a)(4) (2013) (emphasis added).

[46] *See* Ex. EPG-34A at 2 of 3.

[47] *See* ID, 139 FERC ¶ 63,020 at PP 75-77. *See also El Paso Natural Gas Co.*, 129 FERC ¶ 61,006, at PP 31-32 (2009) (finding that El Paso's actual costs were so intertwined with its deemed costs that the actual costs were unverifiable). The Presiding Judge found that the instant Account 813 costs did not present this confusion.

[48] ID, 139 FERC ¶ 63,020 at P 77 (citing Ex. S-59 at 19 (Trial Staff cost of service) (incorporating adjustment for actual other gas supply expense); Ex. SCG-1 at 6-7, and Ex. SCG-2 at 1 (proposing El Paso cost of service based on actual test period costs)).

to establish a question as to the actual nature of the $1.2 million in updated costs. This lack of evidence is in contrast to the treatment of the $5.2 million figure that was opposed by other participants who demonstrated that the figure included accounting entries for natural gas price fluctuations that did not result in actual costs because the underlying imbalance transactions had not been resolved.[49] Indicated Shippers cite no unreliable accounting treatment or cost recovery mechanism that would call into question El Paso's updated cost figure of $1.2 million.

36. The Presiding Judge stated that El Paso was entitled to a presumption that it could recover its costs that are reported consistent with the Commission's test period regulations.[50] The Commission agrees. The Commission has stated "the management of the company is traditionally presumed prudent, and the objecting party must come forward with more than a mere inference of imprudence before the Commission will impute different, lower costs on that basis."[51] The Presiding Judge was correct to find that El Paso's reported cost figure was just and reasonable in the absence of any evidence that would call into question its cost figures.

37. The Commission has stated that the use of end-of-test-period data "reflect[s] the best evidence . . . of what the costs and volumes are expected to be once the rates take effect."[52] This is consistent with the Commission's overarching goal of setting rates based upon costs that are "most likely to be representative of what will occur during the

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[49] At hearing, EPNG's Witness Dougherty stated that El Paso's proposed $5.2 million Other Gas Supply expenses reflected timing differences and associated changes in gas prices between when an imbalance is created and when an imbalance is resolved. Tr. 1247:18-1248:22. El Paso's Witness Dougherty stated that the $5.2 million reflected accounting entries and not actual losses or gains on purchases or sales of gas. Tr. at 1247:18-1248:22. When asked in a data request how much of the $5.2 million amount is attributable to the financial costs for timing differences, El Paso's Witness Dougherty answered that, as stated on page 12 of Ex. EPG-159, the $5.2 million amount of proposed test period costs is a representative level of these types of expenses El Paso is likely to incur on an on-going basis and El Paso's test period level does not detail these amounts by individual cost type. Moreover, El Paso's Witness Dougherty stated that the $1.2 million figure reflected the end of test period actual amount. Tr. 1248:23-1249:7.

[50] ID, 139 FERC ¶ 63,020 at PP 75-77.

[51] *Williston Basin Interstate Pipeline Co.*, 72 FERC ¶ 61,074, at 61,374 (1995) (*Williston I*).

[52] *Id.* at 61,382.

period the rates are in effect."[53] For the reasons discussed above, the Commission affirms the Presiding Judge's determination that the proper Account No. 813 cost is the $1,247,596 end-of-test-period figure provided in El Paso's 45-day update filing.

2. Employee Pensions and Benefits (Account No. 926) (Stipulated Issue III.C)

38. El Paso proposed to recover costs associated with its participation in the pension plan of its corporate parent, El Paso Corp.[54] In its 2011 Rate Case filing, El Paso proposed Account No. 926 pension expenses for the base period of $4,715,118, plus an upward adjustment of $8,281,948, resulting in an as-adjusted total of $12,997,066.[55] In its 45-day update filing, El Paso claimed an updated test period pension expense of $4,518,750 for the twelve-month period ending March 31, 2011.[56]

39. Indicated Shippers and SoCal Gas/San Diego opposed any pension allowance based on the fact that El Paso was not legally required to and did not make any pension contributions during the test period.[57] The protesting parties argued that the trust is currently adequately funded and no additional contributions are required in the test period. They argued that it is inappropriate for El Paso to collect payments from ratepayers to be held in escrow until El Paso is legally required to make additional contributions to the pension trust.

Initial Decision

40. The Presiding Judge found that El Paso's proposal to collect pension expenses without making additional pension trust contributions is "unwarranted, unjust, and unreasonable."[58] The Presiding Judge found that the updated test period figure of $4,518,750 is presumptively just and reasonable, but also stated that the figure "appears to be overstated as an actual allowance."[59] The Presiding Judge further reasoned that the

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[53] *Trunkline Gas Co.*, Opinion No. 441, 90 FERC ¶ 61,017, at 61,048-49 (2000) (*Trunkline*).

[54] ID, 139 FERC ¶ 63,020 at P 81 & n.69 (citing Ex. EPG-231 at 34).

[55] Ex. EPG-41 at line 2 (Schedule H-1(2)(f)).

[56] Ex. EPG-41A at line 2 (Schedule H-1(2)(f)).

[57] ID, 139 FERC ¶ 63,020 at P 81.

[58] *Id.* PP 82-83.

[59] *Id.* P 83.

pension fund historically has been adequately funded, only becoming underfunded "as a consequence of the 2008-2010 economic downturn." The Presiding Judge found that the nonrecurring impact of the 2008-2010 economic downturn should be eliminated as related to the updated test period pension expense. The Presiding Judge found therefore that El Paso should be permitted to normalize the impact of the economic downturn. The Presiding Judge also concluded that El Paso should be permitted to substantiate a normalized annual pension expense in a compliance filing and that any normalized annual pension expense that El Paso is able to substantiate should be included as an annual allowance in its cost of service.

Briefs on Exceptions

41. Trial Staff argues that El Paso's pension expenses should not be included in rates because El Paso's pension trust is fully funded.[60] Trial Staff states that El Paso was not required to make a pension contribution during the test period and that the $4.5 million expense proposed by El Paso was merely an accounting entry reflecting what El Paso might have to pay if a contribution were required. Trial Staff asserts that ratepayers should not fund unnecessary costs.

42. El Paso states that, although the Presiding Judge correctly approved recovery of a pension expense allowance, the Presiding Judge erred by finding that El Paso's updated test period information contained nonrecurring costs resulting from the recent economic downturn and, therefore, that the pension expenses should be normalized.[61] El Paso states that it does not object to the Presiding Judge's decision that El Paso must deposit the pension expense amount collected from shippers into the pension trust instead of first depositing it into an escrow account, but it disagrees that the pension expense allowance should be normalized.

43. El Paso argues that it should not be required to normalize its pension expense allowance for several reasons. El Paso states that the expense level was determined by an independent, third-party actuary. El Paso also contends that the record lacks evidence supporting normalization and that no participant in the proceeding argued that the pension expense allowance should be normalized because the test period pension expense contained non-recurring costs. Finally, El Paso contends that the updated test period expenses are not nonrecurring because the economic downturn to which the Presiding Judge refers is not a nonrecurring event and the downturn ushered in what is projected to be a sustained period of lower asset values and lower earnings on pension assets held in the pension trust, thus making the updated test period figure an accurate reflection of

[60] Trial Staff Brief on Exceptions at 56-57.

[61] El Paso Brief on Exceptions at 63-66.

future costs. Accordingly, El Paso asserts that it should be allowed to recover the full updated test period amount of approximately $4.5 million.

Briefs Opposing Exceptions

44. El Paso contends that its updated test period amount of $4,518,750 is the correct pension amount that should be used to calculate Account No. 926 costs.[62] El Paso argues that Trial Staff does not cite to any authority for the proposition that contributions to a trust must be legally required for them to be recoverable, particularly when the expenses are incurred during the test period and recorded on its books. Further, El Paso states that it will be contributing the funds annually to the trust if the Commission upholds the Presiding Judge's determination. El Paso argues that refusal to include the updated test period pension costs in current rates would simply defer the recovery of such current costs to future ratepayers and would result in intergenerational cross-subsidization.

Commission Determination

45. The Commission reverses the Presiding Judge's holding and finds that no pension expense may be recovered; consequently, no compliance proceeding is necessary. The Commission's Uniform System of Accounts defines pension expense as follows: "This account shall include pension paid . . . or accruals . . . when the utility has definitely, by contract, committed itself to a pension plan under which the pension funds are irrevocably devoted to pension purposes."[63] The Commission's test period regulations require that a pipeline justify any proposed rate increases by filing cost information for a test period consisting of a base period of "12 consecutive months of the most recently available actual experience," and an adjustment period of up to 9 months immediately following the base period. Costs established during the base period may be adjusted for changes which are "known and measurable" and "which will become effective within the adjustment period."[64] The Commission prefers to rely on costs from the last twelve months of the test period for any expense or tax incurred in the test period, including pension expense, as the best evidence of what the costs and volumes are expected to be once the rates take effect.[65]

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[62] El Paso Brief Opposing Exceptions at 25-26.

[63] Account No. 926, Employee pensions and benefits, 18 C.F.R. Part 201 (2013).

[64] 18 C.F.R. § 154.303(a)(1) and (a)(4) (2013).

[65] *Northwest Pipeline Corp.*, 87 FERC ¶ 61,266, at 62,034-35 (1999) (approving actual expense for the last twelve months of the test period for Account No. 926 pension expense) (*Northwest Pipeline*); *Williston I*, 72 FERC at 61,382, *order on reh'g*, 76 FERC

(continued…)

46. In this proceeding, it is undisputed that El Paso made no contribution to the fund in the test period. El Paso requests that the Commission recognize that it may be required to make payments to its pension fund in the future and that it may collect pension costs from ratepayers, beginning with current rates, which it will hold until such time when "legally required funding is indicated."[66] El Paso bases its proposed pension expense on an actuarial study which indicates that, as of January 1, 2010, El Paso may wish to make payment to El Paso Corp.'s pension fund to offset lower fund earnings beginning with the 2008 economic downturn.[67] El Paso proposes to treat pension costs similar to post-retirement benefits other than pensions (PBOP) costs, stating that pension costs are a form of deferred compensation which should be recognized and paid by current ratepayers.[68] However, El Paso's Witness Dougherty admits that no contribution is required in the test period, due to an available credit that offsets potential fund contributions.[69] El Paso explains that, in 2008, the El Paso Corp. pension plan had a net credit of $29.7 million, but had a cost of $50.9 million for the year 2010.[70]

47. To support including pension expense to fund future pension contributions, the Presiding Judge accepted El Paso's assertion that "the pension trust is underfunded as a practical matter, if not a legal one."[71] However, Trial Staff provided evidence showing that fund's legal minimum required contribution level has been met and that no contribution was required or made for the current plan year.[72] In addition, Trial Staff cited El Paso's actuarial study showing a "preliminary quarterly contribution" for the plan year beginning Jan. 1, 2011, with payment "due" in mid-April. El Paso itself reports

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¶ 61,066 (1996) (*Williston Rehearing*), *order on initial decision on remanded issue,* 79 FERC ¶ 61,311, at 62,389 (1997), *remanded by Williston Basin Interstate Pipeline Co. v. FERC*, 165 F.3d 54 (D.C. Cir. 1999) (*Williston v. FERC*), *order on remand,* 87 FERC ¶ 61,265, at 62,024 (1999) (addressing ad valorem tax) (*Williston I Remand*).

[66] Ex. EPG-361 at 40 (Dougherty rebuttal test.).

[67] Ex. EPG-361 at 38; Ex. S-3 at 7 (El Paso data responses).

[68] Ex. EPG-361 at 35.

[69] *Id.* at 37.

[70] Ex. EPG-361 at 38 (El Paso reports its share as a $1.2 million credit and $4.5 million in 2010 costs).

[71] ID, 139 FERC ¶ 63,020 at P 82 (citing Ex. EPG-231 at 37-38; Ex. EPG-256).

[72] Ex. S-3 (El Paso data responses).

that it plans to collect funds for eventual contribution to the fund "when legally [contributions are] required."

48. Based on these facts, the Commission reverses the Presiding Judge's ruling that El Paso should begin booking pension expenses based on its plan experience in 2008 through 2010 on the premise that it may be required to make payment in the future. El Paso requests that the Commission treat its pension funding as it treats PBOP funding. However, in addition to the precedent cited above reflecting the Commission's preference to rely on actual end of test period experience, the Commission's regulations, specifically Account No. 926 – Employee pensions and benefits, require more than a discretionary set-aside in anticipation of potential future funding to allocate pension expenses for ratemaking. Account No. 926 permits a utility to book pension expense for "pensions paid . . . or accruals . . . when the utility has definitely, by contract, committed itself to a pension plan under which the pension funds are irrevocably devoted to pension purposes." The Commission has stated that it will waive its test period preference for Account No. 926 amounts when the amount occurring outside of the test period that is proposed to be included in rates is "measurable," "certain to occur," and "significant."[73] Because El Paso points to no payment or pension plan requirement that funds be collected for the plan effective in the test period when there is no definite funding requirement in the foreseeable future, the Commission finds that El Paso's proposal is inconsistent with the Commission's regulations.

49. Even though El Paso presented evidence that its proposed pension expense figure is derived from actuarial reports, El Paso did not establish that it was meeting, or will meet, an obligation to fund the additional pension amounts, either by showing actual payment or any other requirement that it make payment. El Paso has not shown that it was legally required to make a pension expense nor has it shown that it deposited money into an account designated for employee pensions.

50. Insofar as El Paso's claim is based on temporary financial conditions, El Paso has failed to establish any basis for its claim that any future payment will be necessary. Accordingly, the Commission reverses the Presiding Judge's determination that an actuarial report's projections regarding future expenses creates a definite future expense that is properly includable in rates.

51. The Commission stated that in determining the proper amount of a rate component, there is no guarantee of "automatic approval of either inclusion of the

[73] *Panhandle Eastern Pipe Line Co.*, Opinion No. 404, 74 FERC ¶ 61,109, at 61,365 (1996) (*Panhandle I*).

particular item or inclusion of the precise amount claimed for that item."[74] This is the case, even if the accounting treatment is required by the Internal Revenue Code.[75] The critical element is that the rate component must be spent or a liability must be imposed during the test period and any deviation must be adequately justified. In this instance, El Paso seeks to recover costs that it did not actually pay during the base period or the adjustment period, but which an actuary found necessary to fund El Paso's future pension benefits because of temporary and extreme economic conditions existing at the time.[76] El Paso has the burden to justify its attempted recovery of that cost-of-service item.[77] El Paso has not supported, other than by a reference to accounting procedures and unproduced actuarial reports, why its customers should pay for monies not spent or expenses not incurred or otherwise definitively accrued.

52. The Presiding Judge determined that historically, El Paso's pension trust has been funded adequately and only recently has become potentially underfunded as the result of the 2008-2010 economic downturn. The Presiding Judge found that the downturn was a non-recurring event requiring normalization. It appears that a major justification of El Paso's projected pension shortfall is the 2008-2010 downturn and the ongoing low interest rate environment following it.[78]

53. The Commission has found that permitting a future rate increase based on a predicted increase in a single cost item would be unwise, as other costs may well go down or throughput could go up during the interim period.[79] In this proceeding, El Paso

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[74] *Southwestern Public Service Co.*, 51 FERC ¶ 61,130, at 61,369 (1990) (denying rate base treatment of a pension expense).

[75] *See Southwestern Public Service Co.*, 48 FERC ¶ 61,156, at 61,598 (1989).

[76] *See* Ex. EPG-204 at 10-12. El Paso's Witness Tatman stated that the pension expenses were not actual cash payments made into pension accounts but were book entries based upon projections contained in recent actuarial reports.

[77] *Consolidated Gas Supply Corp.*, 14 FERC ¶ 61,029, at 61,053-54 (1981).

[78] *See* El Paso Brief on Exceptions at 64. El Paso advances the argument that "the economic downturn ushered in what is projected to be a sustained period of lower asset values and lower earnings on pension assets held in the pension trust" and its actuarial report forming the basis of its pension expense position was "consistent with the Federal Reserve's ongoing low interest rate policy."

[79] *See Williston Basin Interstate Pipeline Co.*, 59 FERC ¶ 61,237, at 61,809 (1992) (*Williston II).*

proposes to recover a future projected pension obligation based on nonrecurring economic conditions created by the downturn. El Paso cites an increase in fund expense created by that event and proposes to begin collecting funds to meet its share of projected future expense. In addition to relying on point-in-time projections in the actuarial study,[80] El Paso ignores the fact that continued economic recovery suggests that the fund will return to normal operations and again experience increased earnings and offsetting credits that will lessen the likelihood that El Paso will be legally required to contribute to the pension fund. However, El Paso's projections and self-imposed pension expense obligations make no provision for such a possibility. Furthermore, it would be unfair to adjust El Paso's rates based on the single pension item because any future economic changes may affect other rate factors, such as potentially increasing El Paso's throughput.[81] For these reasons, the Commission finds that El Paso's proposed Account No. 926 expense based on potential pension payments supported by its point-in-time actuarial study is too speculative to qualify as a known and measurable change in the test period and does not support an out-of–test period adjustment based on actual future activity. Consequently, the Commission rejects El Paso's proposal to collect pension expenses in rates and hold such funds in escrow when such payments are not currently required as inconsistent with the Commission's test period regulations and policies.

B. <u>Compressor Station Overhaul and Periodic Maintenance Expenses (Stipulated Issue III.E)</u>

54. El Paso proposes to include a $2,839,868 calendar year 2010-derived Compressor Station Overhaul expense and a projected $0.6 million Periodic Maintenance expense[82] in its annual cost of service.[83] El Paso reasons that these expenses are more representative than the twelve month updated test period figure of $2.2 million proposed by Trial Staff.

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[80] *See* Ex. S-3 at 7 ("required contributions are determined as of the valuation date"). Even if post-test period expenses were shown to have actually been paid or incurred (and El Paso does not cite any related out-of-test-period payment), the use of amounts outside the test period is contrary to Commission's policy of using amounts incurred within the test period.

[81] *Williston II*, 59 FERC ¶ 61,237 (out-of-test-period costs based on accounting changes effective outside the test period and finding it unfair to adjust one out of test period cost item, while not capturing changes in the other rate factors).

[82] El Paso projects spending over the next three years of $1.8 million to strip and re-paint the Colorado River Arch Bridge; the $0.6 million is the single year representative amount. *See* ID, 139 FERC ¶ 63,020 at P 86 n.80 (citing Ex. EPG-293 at 9).

[83] ID at P 86 (citing Ex. EPG-295; Ex. EPG-293 at 9).

Trial Staff, Indicated Shippers, and SoCal Gas/San Diego oppose deviating from the accepted updated test period combined amount of approximately $2.2 million for both expense categories.

Initial Decision

55. The Presiding Judge found that the updated test period expenses of $2.2 million for Compressor Station Overhaul and Periodic Maintenance are the presumptively correct figures and that El Paso failed to overcome the presumption that the test period amount from the 12 months ending March 31, 2011, is the just and reasonable amount. Specifically, the Presiding Judge found that the updated test period expenses contained Compressor Station Overhaul costs for seven compressor station overhauls, although El Paso proposed to use the cost of overhauling ten compressor stations per year based upon calendar year 2010 figures. The Presiding Judge pointed out that El Paso presented no data or evidence of any historical experience supporting the proposed ten overhauls per year other than the calendar year 2010 data, and the 2010 data, which reflect only eight overhauls.

56. Similarly, the Presiding Judge found that El Paso also failed to overcome the presumption that the proper Periodic Maintenance cost is the updated test period amount. The Presiding Judge stated that El Paso's proposal is based on projections that cannot be used unless the data demonstrate that test period cost projections will be "seriously in error."[84] The Presiding Judge found that El Paso does not propose to rely on post-test period cost data, but instead proposes to rely on a normalized three- year advance total cost projection for the Arch Bridge project, which it claims is "representative" of the annual Periodic Maintenance expense it will experience.

Briefs on Exceptions

57. El Paso argues that the Presiding Judge erred by rejecting its proposed Compressor Station Overhaul expenses based on actual 2010 data.[85] El Paso explains that it substituted three months of base period data from the first quarter of 2010 for three months of test period data from the first quarter of 2011 because the later three months were skewed by extreme cold weather during February 2011, which a Commission staff report characterized as "unprecedented."[86] El Paso states that it is well established that

[84] *Id.* P 89 (citing *Ozark Gas Transmission, LLC*, 134 FERC ¶ 61,193, at P 26 (2011); *Williston I Remand*, 87 FERC at 62,022).

[85] El Paso Brief on Exceptions at 66-70.

[86] *Id.* at 67; *see* Sept. 15, 2011 FERC Staff Report on SW Cold Weather Event, reproduced as Ex. EPG-409 at 7; Ex. EPG-293 at 9.

reasonable adjustments to test period data can and should be made to eliminate the impact of such anomalous or non-recurring events and to establish representative cost levels.

58. El Paso states that the Presiding Judge erred in determining that only seven or eight compressor station overhauls were conducted in calendar year 2010 because Exhibit No. EPG-295 clearly and unambiguously shows that ten overhauls were performed by El Paso in the 2010 period.[87] El Paso states that the extreme cold weather in the first quarter of 2011 prevented it from performing as many compressor station overhauls as it typically would. El Paso asserts that the Commission should reverse the Initial Decision and approve inclusion of the $2,839,868 Compressor Station Overhaul expense based, in part, on data from the base period.[88] El Paso states that if the Commission does not reverse the Presiding Judge, the correct updated test period amount for the twelve months ending March 31, 2011, would be $2,839,868 minus the $0.6 million Periodic Maintenance expense excluded by the Presiding Judge.[89]

Briefs Opposing Exceptions

59. Trial Staff contends that El Paso's compressor station overhaul expenses should be based on the updated test period data rather than actual 2010 data.[90] Trial Staff contends that El Paso has not shown, based on actual cost data, that its updated test period compressor station overhaul expenses are "seriously in error."[91] Trial Staff states that the difference between the updated test period cost and the calendar year 2010 cost is just a

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[87] *Id.* at 68-69.

[88] El Paso argues that it has overcome any presumption that the use of updated test period data is just and reasonable because its witness did provide evidence of compressor station overhaul expenses of $3.9 million for 2009 and $4.3 million for 2008, on the record (citing Tr. 1111).

[89] El Paso does not contest the Presiding Judge's determination that its Periodic Maintenance expense of $0.6 million should be excluded. *See* El Paso Brief on Exceptions at 66, 69-70, n.95 (citing Ex. EPG-293 at 7 for support of the $2.2 million Compressor Station Overhaul expense figure).

[90] Trial Staff Brief Opposing Exceptions at 72 (citing Ex. S-1 at 9-10; *Williston I*, 72 FERC at 61,382).

[91] *Id.* at 73 (citing *Williston I Remand*, 87 FERC at 62,022, which states that when considering post-test period data in ratemaking, "the Commission generally requires that the post-test period data show that projections based on test period data will be seriously in error."); *Ozark Gas Transmission, LLC*, 134 FERC ¶ 61,193 at P 26).

little over $600,000, which is not significant enough to show the test period figure to be seriously in error. Trial Staff argues that the Commission does not allow companies to "cherry-pick" their post-test-period costs.[92]

60. Trial Staff maintains that it is unreasonable to conclude that one week of very cold weather during the first week of February 2011 prevented El Paso from completing compressor station overhauls for the entire three-month period El Paso would replace. Further, Trial Staff states that El Paso should not be permitted to mismatch cost data from one time period with cost and throughput data from another time period. Trial Staff contends that El Paso presented no supporting documents or calculations to justify the $3.9 million in compressor overhaul expenses in 2009 and $4.3 million in compressor overhaul expenses in 2008 proffered by El Paso's Witness Gerber.[93] For these reasons Trial Staff contends that the just and reasonable expense level for compressor station overhaul expenses is the updated test period figure.[94]

Commission Determination

61. The Commission affirms the Presiding Judge's decision that the appropriate expense amount for compressor station overhauls is the updated test period amount of $2.2 million.[95] The Commission allows deviations from test period when "the post-test period data show that projections based on test period data will be seriously in error."[96] A similar analysis is warranted here, where the updated test period consisting of the twelve months ending March 31, 2011, has been established based on the most reliable and recent data. The record does not show that the updated test period amount is seriously in error, and, furthermore, the record lacks evidence establishing a historical base figure for compressor station overhaul expense.

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[92] *Id.* at 73.

[93] *Id.* at 75 (citing Tr. 1111-12).

[94] *Id.* at 74-75.

[95] *See* ID, 139 FERC ¶ 63,020 at P 59 n.84 (referencing El Paso Initial Br. at 39 and requesting the validity of the $2 million figure be confirmed by the parties in their briefs on exceptions). The $2.2 million amount is confirmed by El Paso in its Brief on Exceptions at 66 n.86.

[96] *See* Trial Staff Initial Br. at 50 (citing *Williston I Remand,* 87 FERC at 62,022; *Ozark Gas Transmission, LLC,* 134 FERC ¶ 61,193 at P 26).

62. El Paso asserts that extreme and unprecedented cold weather during the winter of 2011 forced delays of compressor station overhauls and justifies use of its proposed time period. However, even if some lower level of compressor station overhaul costs resulted from the cold weather incident, El Paso did not present evidence of prior actual compressor station overhaul expenses against which the difference could be compared. Further, the Commission acknowledges Trial Staff's objection that the brief cold snap does not fully explain a slowdown that would justify rejecting three months of data. Although El Paso's Witness Gerber testified that El Paso incurred $3.9 million in compressor overhaul expenses in 2009 and $4.3 million in compressor overhaul expenses in 2008, El Paso presented no supporting documents or calculations demonstrating typical compressor station overhaul expenses during several previous years' winter months, other than the one year of data it proposed to substitute in place of the updated test period amount.[97] There is not enough evidence in the record to determine that the updated test period figure is substantially in error, as compared to El Paso's higher proposed compressor station overhaul cost.

63. Similarly, the Commission affirms the Presiding Judge's finding that El Paso has not supported its proposed Periodic Maintenance expense, which represents an impermissible deviation from the established test period because it is based on projected, not incurred costs. El Paso's proposal is based on a three-year normalized cost projection related to the Arch Bridge project.[98] The Presiding Judge found that the only Periodic Maintenance expense related to the Arch Bridge project that occurred during the test period was $29,000 incurred around July 2010 to assess and inspect the bridge's condition.[99] The Presiding Judge found no evidence of any other expense incurred prior to November 1, 2011.

64. The Presiding Judge found that El Paso did not rely on updated test period figures, but rather relied upon the normalization of a three-year projected cost total. Because he found no connection between the costs incurred within the test period and the projected future total cost of the Arch Bridge project, the Presiding Judge ruled that El Paso could not recover any Periodic Maintenance expense related to the Arch Bridge project.[100]

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[97] Tr. 1111.

[98] *See* ID, 139 FERC ¶ 63,020 at P 86 n.80 (citing Ex. EPG-293 at 9). The Arch Bridge is a 600-foot span over the Colorado River near Topock, Arizona that El Paso plans to strip and re-paint at a total estimated cost of $1.8 million over a three-year period.

[99] *See id.* P 89 n.87 (citing SCG-55; Tr. 1103).

[100] *See id.*

Further, El Paso stated that it did not oppose the Presiding Judge's exclusion of Periodic Maintenance costs.[101] The Commission affirms the Presiding Judge's determination that El Paso has not demonstrated that its normalized cost projection is representative of the pipeline's annual Periodic Maintenance expense.[102]

C. Rate Case Expenses / Regulatory Commission Expenses (Account No. 928) (Stipulated Issue III.F)

65. El Paso proposed a rate case expense level of $2,575,247 from its Account Nos. 921 (Office Supplies and Expenses) and 923 (Outside Services).[103] In the alternative, El Paso proposed to use a three-year average of 2008, 2009, and 2010 actual expenses of $1,920,608.[104] Trial Staff and Indicated Shippers contended that the updated test period figure should be normalized over three years, resulting in an annual rate case expense allowance of $858,416. Alternately, Trial Staff proposed to substitute El Paso's unadjusted 2008-2010 three year average expense of approximately $1.7 million, arguing that El Paso's updated three-year average was untimely.[105] SoCal Gas/San Diego acknowledged El Paso's filed exhibits reflect a test period allowance, but supported El Paso's 2008-2010 three year average expense of $1,920,608.

Initial Decision

66. The Presiding Judge held that the appropriate amount for rate case expenses is the updated test period amount of $2,575,247.[106] The Presiding Judge found that the updated test period amount was the presumptively just and reasonable figure. The Presiding Judge found that SoCal Gas/San Diego's evidence supported a test period allowance, despite their position supporting the average figure.[107]

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[101] *See* El Paso Brief on Exceptions at 66.

[102] *See* ID, 139 FERC ¶ 63,020 at P 89.

[103] *See* Ex. EPG-40A; Ex. EPG-293 at 12 (El Paso Witness Gerber rebuttal test.).

[104] *See* Ex. EPG-293 at 13 (citing Ex. No. EPG-296); *see also* El Paso Initial Br. (corrected) at 42 (stating the previous $1.7 million figure mentioned in Ex. EPG-293 was corrected to the $1,920,608 figure).

[105] ID, 139 FERC ¶ 63,020 at P 90 n.89 (rejecting discovery objection).

[106] *Id.* PP 91-93.

[107] *Id.* P 90 n.90.

67. El Paso's Witness Gerber reported that costs were assigned to Account Nos. 921 and 923, instead of Account 928, Regulatory Commission Expense, due to a "glitch." Because Account Nos. 921 (Office Supplies and Expenses) and 923 (Outside Services) are general expense accounts, the Presiding Judge noted some confusion in the record as to whether El Paso's totals reflected solely rate case expenses. The Presiding Judge therefore directed that in calculating its rates, El Paso must reduce the totals identified at hearing by any included non-rate case expenses.[108] Thus, any claimed expenses must not include administrative expenses attributable to other activities that might be booked into FERC Account Nos. 921 and 923.

68. The Presiding Judge found that El Paso had a test period rate case expense totaling $2,575,247, with $2,315,358 for 2010 rate case expense, $2,387,099 for 2009 and $1,059,366 for 2008.[109] According to the Presiding Judge, these totals established that the 2008 expense is the anomalous figure, not the test period total. The Presiding Judge concluded it would be unrepresentative for rate case expense allowance purposes to calculate an average by including the 2008 expense. The Presiding Judge found that normalizing the indicated test period figure over three years would produce an annual rate case expense allowance of only $858,416, which would be yet more unrepresentative.[110]

69. The Presiding Judge found that the test period expense is presumptively just and reasonable and that the updated test period amount is not materially higher than the 2010 and 2009 amounts.[111] The Presiding Judge also stated that the record strongly suggests that the test period rate case expense is in fact representative of El Paso's annual expense level going forward, considering the ongoing proceedings in the 2006 Rate Case, the 2008 Rate Case, and the Fuel Complaint Case proceedings. Moreover, the Presiding Judge observed that rate case expenses could climb significantly higher, given the number of proceedings in which El Paso is involved.[112]

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[108] *Id.* P 91.

[109] *Id.* P 92; Ex. S-32 at 2-6.

[110] ID, 139 FERC ¶ 63,020 at P 92.

[111] *Id.* P 93.

[112] *Id.* (citing Ex. EPG-293 at 15-17).

Briefs on Exceptions

70. El Paso states that the Commission should affirm the Presiding Judge's ruling finding that the $2,575,247 rate case expense is the just and reasonable amount because it does not include any non-rate case expenses, and therefore requires no adjustment.[113]

71. Trial Staff argues that an appropriate rate case expense level should be based on a three-year normalized test period amount or, in the alternative, on a four-year average, including the rate case expenses for 2007 along with those from 2008, 2009, and 2010.[114] Trial Staff argues that the Presiding Judge's approval of the $2,575,247 end-of-test period rate case expense, which is higher than any annual rate case expense recorded by El Paso from calendar years 2007 through 2010, is unjust and unreasonable. Trial Staff contends that the Presiding Judge correctly acknowledges that the general Commission approach for rate case expenses is to look at three to five years of historical data. Trial Staff emphasizes that its witness, Mr. Steen, proposed a three-year amortization of El Paso's test period costs of $2,575,247, or $858,416 to be recovered in rates each year for three years.[115] Further, states Trial Staff, the four-year average of rate case expenses for the calendar years 2007 to 2010 is $1,771,196. Trial Staff argues that this alternative proposal produces a reasonable representation of future annual cost levels by weighting two years of extensive litigation (2009 and 2010), with one year of moderate litigation (2008) and one year of little litigation (2007).

Briefs Opposing Exceptions

72. El Paso contests Trial Staff's argument that the rate case expenses in the test period are not representative. El Paso notes that Trial Staff relies on rate case levels in 2007 and 2008, when El Paso was involved in little to moderate litigation. El Paso argues that more recent data from 2009 and 2010, as well the Presiding Judge's expectation of higher expense levels, are more reliable and reasonable indicators of expenses than stale data from four-five years ago. El Paso opposes Trial Staff's contention that El Paso's pending rate cases are either "close to completion or will be completed soon."[116] El Paso points out that Trial Staff fails to acknowledge the ongoing disputes that continually arise in these cases, such as rehearing requests, disputes over

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[113] El Paso Brief on Exceptions at 70-71.

[114] Trial Staff Brief on Exceptions at 57-61.

[115] *Id.* at 59-60 (citing Ex. S-1 at 20-21, Ex. S-59 at 21).

[116] El Paso Brief Opposing Exceptions at 27 (citing Trial Staff Brief on Exceptions at 59-61).

compliance filings, and potential court appeals. El Paso adds that new and continuing litigation will likely ensue in the future, as an examination of the history of El Paso's system suggests. El Paso suggests that Trial Staff's amortization proposal is incorrectly calculated and that a three-year amortization period would include 2008/2009/2010. El Paso supports the Presiding Judge's conclusion that El Paso's actual test period rate case expense level of $2,575,247 is representative, just and reasonable, and supported by the evidence.[117]

Commission Determination

73. The Commission finds that the three-year average rate case expense is the appropriate cost figure. The Commission's general approach is to look at a historical three- or five-year period in order to establish a representative level of a pipeline's future Regulatory Commission Expense level during the period the rates are effective.[118] The averaging of annual amounts is preferred because the Commission can easily verify the rate-case expense level by examining the Form No. 2 information filed in previous years by the rate case applicant.[119] In the absence of sufficient historical data, or where the record indicates that the historical data are not reflective of potential future expense levels, the Commission may consider test period annual amount as representative of the future expense level, even if it is not normalized.[120]

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[117] *Id.* at 27-28.

[118] *Kern River Gas Transmission Co.*, Opinion No. 486, 117 FERC ¶ 61,077, at P 278 (2006) (addressing Account No. 928, Regulatory Commission Expenses), *order on reh'g*, Opinion 486-A, 123 FERC ¶ 61,056 (2008), *order on reh'g*, Opinion 486-B, 126 FERC ¶ 61,034, *order on reh'g*, Opinion No. 486-C, 129 FERC ¶ 61,240 (2009), Opinion No. 486-D, 133 FERC ¶ 61,162 (2010), *order on reh'g*, Opinion No. 486-E, 136 FERC ¶ 61,045 (2011) (*Kern River*).

[119] *See*, *e.g.*, *Williston Basin Interstate Pipeline Co.*, 84 FERC ¶ 61,081, at 61,365 n.39 (1998) (*Williston III*) (relying on Form No. 2 data to support its determination on the just and reasonable regulatory expense level); *Northwest Pipeline Corp.*, 92 FERC ¶ 61,287, at 61,991 (2000) (stating that Form No. 2 information is a matter of Commission record which is available to the public and the Commission may take notice of such information); *see also Algonquin Gas Transmission Co.*, 48 FPC 445, at 462-63 (1972) (hearing examiner taking official notice of FERC Form No. 2 data to determine regulatory expense).

[120] *Williston III*, 84 FERC at 61,366.

74. However, the Commission's policy is to approve regulatory expense amounts based upon the average of three calendar years ending with a year falling within the test period.[121] In this proceeding, El Paso's briefs and exhibits provide the information necessary to calculate a three-year average. The Commission prefers the three-year average given the fluctuating nature of regulatory commission expenses. In addition, the average strikes a balance between the highest year of the period (2010, the year inside the rate case test period), and the lowest year (2008, when there was less expense). Thus, because the policy was developed to accommodate fluctuating expense levels, the Commission finds it appropriate to apply here and average the expense levels from the prior three years.

75. The Commission disagrees with Trial Staff's proposal to amortize El Paso's updated test period amount over three years. That approach may be appropriate where a pipeline had no historic data, but nevertheless incurred substantial regulatory expenses in a single year, due to the need to litigate a proceeding that was not anticipated to affect future expense levels. The Commission expects that El Paso will not continue to incur extremely high regulatory expenses as issues related to these proceedings are resolved.

76. Therefore, the Commission reverses the Presiding Judge's decision and finds that El Paso's corrected three calendar year average of 2008, 2009, and 2010 actual rate expense of $1,920,608 is just and reasonable, consistent with Commission policy, and, given El Paso's verification that it does not include non-rate case expenses, that El Paso should calculate its rates using this figure for regulatory expenses.[122]

IV. Depreciation and Negative Salvage

A. Mainline Transmission and Storage Depreciation Rates (Stipulated Issue IV.A)

77. El Paso requested that the Commission approve a range of depreciation rates based on its existing rates (2.20 percent for transmission plant and 1.09 percent for underground storage plant) serving as floor rates, and its proposed rates (3.07 percent for transmission plant and 2.42 percent for underground storage plant) serving as ceiling rates. According to El Paso, its floor rates are contingent on the Commission making no changes to its other cost of service elements. If changes are made, El Paso proposed to offset any reductions in other cost of service elements with an increase in depreciation rates (up to

[121] *See Portland Natural Gas Transmission Sys.*, Opinion No. 510, 134 FERC ¶ 61,129 (2011); *Williston III*, 84 FERC at 61,364-66; *Iroquois Gas Transmission System, L.P.*, 81 FERC ¶ 63,012, at 65,087-88 (1997).

[122] El Paso Brief on Exceptions at 70-71.

the proposed ceiling rates) so as to maintain recourse rate levels. Trial Staff argued that El Paso's proposal for a range of depreciation rates is inappropriate and supported the existing depreciation rates of 2.20 percent and 1.09 percent for mainline transmission and storage, respectively. Indicated Shippers supported the Trial Staff position.

Initial Decision

78. The Presiding Judge rejected El Paso's proposal to establish a range of acceptable depreciation rates, as well as the associated compliance filing procedure that would provide for the implementation of final depreciation rates. Instead, the Presiding Judge found that El Paso succeeded only in supporting its existing depreciation rates, which were approved by settlement in the 2008 Rate Case.[123]

79. In rejecting El Paso's proposed depreciation ranges as inappropriate, the Presiding Judge disagreed with El Paso's contention that the Commission can determine a range of depreciation rates, much as it does currently for equity returns.[124] According to the Presiding Judge, there are several key distinctions between the Commission's determination of ranges for equity returns and El Paso's proposed procedures for a range of depreciation rates. The Presiding Judge explained that the most glaring difference is that the ROE methodology is predicated on well-defined Commission policies, Commission-specified inputs and calculations, and a proxy group control, which itself is selected in accordance with detailed Commission-defined criteria. In addition, the Presiding Judge stated that El Paso cites no authority to support the analogy, and he also found that El Paso impermissibly seeks to link depreciation rates to unrelated cost of service elements, effectively nullifying discrete and legitimate disallowances.

80. The Presiding Judge further ruled that the proper forum for El Paso to establish its legitimate depreciation rates is in the current proceeding, which was created by the Commission explicitly for that purpose, rather than in a compliance filing, as El Paso proposed. In addition to expressing doubt as to his authority to order such a compliance proceeding, the Presiding Judge found El Paso's proposal so obtuse as to be unworkable.[125]

81. Having rejected El Paso's range of depreciation rates, the Presiding Judge found considerable inconsistencies or, at a minimum, sources of confusion for determining the

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[123] ID, 139 FERC ¶ 63,020 at P 98 (citing *2008 Rate Case Settlement Order,* 131 FERC ¶ 61,077 at P 6).

[124] *Id.* P 99.

[125] *Id.* P 100.

proposed rates for transmission and storage plant. While El Paso attempted to support depreciation rates as high as 3.07 percent for transmission plant and 2.42 percent for underground storage plant, the Presiding Judge quoted the witness on whose analysis El Paso relied:

> I understand that in this case, [El Paso] is using my analysis to confirm that its existing rates of 2.20 percent for transmission and 1.09 percent for storage assets are not excessive. Based on my study and its results, I conclude that [El Paso's] existing rates are not excessive at this time.[126]

82. The Presiding Judge considered it unlikely that the Commission would approve all other elements of El Paso's proposed cost of service; thus, the Presiding Judge stated it appeared that El Paso was implying that its default proposed depreciation rates are 3.07 percent for transmission plant and the 2.42 percent for storage plant. However, the Presiding Judge determined that El Paso's testimony unequivocally stated that the underlying depreciation study confirms the current 2.20 percent transmission plant rate and 1.09 percent storage plant rate are not excessive.

83. As a result, the Presiding Judge found that the record compels a conclusion that El Paso failed to satisfy its burden to prove that depreciation rates for transmission plant of 3.07 percent and storage plant of 2.42 percent were just and reasonable. However, the Presiding Judge found that El Paso provided adequate support to retain its existing rates of 2.20 percent for transmission plant and 1.09 percent for storage plant.

Briefs on Exceptions

84. El Paso argues that the Presiding Judge erred by rejecting its depreciation proposal. Specifically, El Paso contends that the Presiding Judge misconstrued its position by focusing on one discrete part of its witness's testimony in which he relied on his depreciation study to support the conclusion that El Paso's existing rates were not excessive. El Paso contends that its witness clearly stated that the higher transmission and storage depreciation rates of 3.07 and 2.42 percent could be supported by El Paso.[127] In this regard, El Paso argues that its witness stated in rebuttal testimony that "if any element of the filed recourse rate level is reduced by the Commission, El Paso proposes that my 3.07 percent transmission plant rate and my 2.42 percent underground storage rate should be used to the extent necessary to bring the recourse rate levels back up to

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[126] *Id.* P 102 (citing Ex. EPG-130 at 4).

[127] El Paso Brief on Exceptions at 73 (citing Ex. EPG-130 at 4).

what El Paso filed."[128] In El Paso's view, therefore, the fact that its witness relied on his analysis to demonstrate that El Paso's existing depreciation rates are not excessive does not mean that his analysis cannot also support higher depreciation rates.

85. El Paso also disputes the Presiding Judge's statement that the establishment of a range of reasonable depreciation rates is materially different from creating a range of reasonable equity returns. El Paso asserts that the Commission recognizes that there is no single correct ROE and therefore requires an applicant to develop a range of reasonable returns from which to choose. According to El Paso, the development of the range of returns incorporates subjective judgments and estimates, including projected short-term growth rates and proxy group selections, to calculate a range of reasonable returns. Similarly, El Paso argues that the selection of an appropriate depreciation rate requires a number of inputs and subjective judgments, including estimates and assessments of the average remaining service lives of a myriad of pipeline assets, survivor curve analyses, economic life and physical life determinations, and gas supply determinations.[129] Given these similar, subjective determinations, El Paso contends that the development of a range of reasonable depreciation rates is appropriate and warranted.

86. In response to the Presiding Judge's doubt as to his authority, El Paso argues that, because the Commission has never used a range of reasonableness approach for establishing a depreciation rate, this fact does not demonstrate that such use is inappropriate. El Paso also asserts that court precedent clearly supports its depreciation range proposal, citing language in the *Memphis Light* decision, which states that "[w]e recognize there is no one 'correct' depreciation rate; thus, the Commission could develop a range of rates which would fall within a 'zone of reasonableness.'"[130] El Paso concludes that such findings would be sustained if supported by record evidence.

87. Moreover, continues El Paso, the linkage of depreciation rates to cost of service reductions is reasonably intended to produce rates that are supported by the evidence and within lawful limits. To ensure that its depreciation rates do not result in transportation rates higher than its filed rates, El Paso proposed that the depreciation rates be increased commensurate with Commission-mandated reductions in other elements of the cost of service.[131]

[128] *Id.* (citing Ex. EPG-350 at 3).

[129] *Id.* at 74 (citing Ex. EPG-130 at 12-34, EPG-350 at 4-6, S-4 at 22-23, 26, 28).

[130] *Id.* at 75 (citing *Memphis Light, Gas and Water Div. v. FPC,* 504 F.2d 225, 235 (D.C. Cir. 1974) (emphasis deleted) (*Memphis Light*)).

[131] *Id.* at 75.

88. El Paso states that its witness conducted a thorough analysis of El Paso's operations in developing ceiling depreciation rates for transmission plant and underground storage as high as 3.07 percent and 2.42 percent, respectively. El Paso states that only Trial Staff contested El Paso's depreciation study. Moreover, El Paso states that Trial Staff's argument against the use of three years of post-test-period plant additions is misplaced because the Commission has accepted this before. El Paso also disputes Trial Staff's claims that El Paso's witness's selection of survivor curves is unsupported. On the contrary, El Paso states that its witness determined the survivor curves by examining actual plant additions and retirement data.[132]

89. Though supporting the Presiding Judge's rejection of El Paso's depreciation proposal, Trial Staff nonetheless argues that the Presiding Judge incorrectly finds that Trial Staff failed to affirmatively support El Paso's existing depreciation rates. Accordingly, Trial Staff excepts to the Initial Decision on this issue.[133] Trial Staff argues that its witness provided 27 pages of answering testimony supporting El Paso's current mainline transmission and storage depreciation rates.[134] Specifically, Trial Staff argues that its witness calculated a rate of 2.22 percent for transmission plant versus El Paso's existing rate of 2.20 percent, and he calculated a rate of 1.60 percent for underground storage versus El Paso's existing rate of 1.09 percent. In doing so, argues Trial Staff, its witness supported his conclusion that El Paso's existing mainline transportation and storage depreciation rates are just and reasonable by conducting an exhaustive analysis of supply, demand, and competition on El Paso's pipeline system.[135] According to Trial Staff, its witness's depreciation study justifies the continuation of El Paso's existing rates.[136]

Briefs Opposing Exceptions

90. Trial Staff contends that El Paso simultaneously supports and seeks changes to its existing, filed-for transmission and storage depreciation rates, creating an equivocation as to which rates it proposes to support. Specifically, Trial Staff states that El Paso argues that (1) its proposed floor rates are within the zone of reasonableness; and (2) these rates

[132] *Id.* at 79 (citing Ex. EPG-130 at 5 and Ex. EPG-351).

[133] Trial Staff Brief on Exceptions at 62.

[134] *Id.* (citing Ex. S-4 at 8-35).

[135] *Id.* at 62-63 (citing Ex. S-4 at 7).

[136] *Id.* (citing Ex. S-4 at 34-35 and Ex. S-6, Schedule 1 and 10).

were inadequately supported by Trial Staff's witness and would result in an undercollection of its depreciation expense.[137]

91. Trial Staff asserts that the Presiding Judge correctly concluded that the establishment of a range of reasonable depreciation rates is materially different than setting a range of reasonable equity returns. According to Trial Staff, El Paso should not be allowed to select transmission and storage depreciation rates within a range based on extraneous factors *having absolutely nothing to do with* El Paso's depreciation calculation.[138] Trial Staff also maintains that the Presiding Judge correctly ruled that El Paso's proposal to determine its depreciation rates in a future compliance filing is inappropriate. Trial Staff contends that El Paso's proposal would essentially allow it to avoid the cost of service and rate reductions required by the Commission's rulings in this proceeding.

92. Trial Staff also contends that the Presiding Judge correctly ruled that El Paso failed to support or define its position regarding its ceiling depreciation rates of 3.07 percent for mainline transportation and 2.42 percent for storage. Trial Staff states that if the Commission considers the higher contingent transmission and storage depreciation rate ceilings proposed by El Paso's witness, it should find that (1) those rates are not just and reasonable and should be rejected; and (2) El Paso's existing mainline transportation and storage depreciation rates are just and reasonable and should be maintained.[139]

93. Trial Staff opposes El Paso's contention that the Presiding Judge erred by not adopting the Trial Staff witness's mainline transmission and storage depreciation rates of 2.22 percent and 1.60 percent for storage, respectively, which are higher than El Paso's existing depreciation rates.[140] Trial Staff contends that because El Paso's existing rates were supported by El Paso, and proposed by both El Paso and Trial Staff, the Presiding Judge did not need to adopt the higher rates in the study done by Trial Staff's witness. However, if the Commission does not affirm the Initial Decision, Trial Staff does not oppose adoption of its witness's calculated depreciation rates.[141]

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[137] Trial Staff Brief Opposing Exceptions at 77-78.

[138] *Id.* at 79 (emphasis in original).

[139] *Id.* at 86-87.

[140] *Id.* at 111.

[141] *Id.* at 112.

94. Indicated Shippers generally support Trial Staff's arguments for affirming the Initial Decision. Among other things, Indicated Shippers argue that El Paso misinterprets the *Memphis* decision, and while relying on stray *dicta* therein, completely disregards the actual determinations the *Memphis* court made. Indicated Shippers argue that El Paso is incorrect that the Commission can approve a range of depreciation rates, which can then be adjusted as long as they are below the rates initially filed by El Paso. Indicated Shippers argue that in the M*emphis* decision, it is clear that only one depreciation rate can be stated for a given pipeline.[142] Indeed, Indicated Shippers point out that El Paso acknowledges that "the Commission has never used a range of reasonableness approach for establishing a depreciation rate."[143]

95. El Paso challenges Trial Staff's exceptions, arguing that the record shows that Trial Staff failed to affirmatively support El Paso's pre-existing mainline transmission plant depreciation rate or the storage depreciation rate. El Paso asserts that the only depreciation rates Trial Staff affirmatively supported were its witness's proposed transmission and storage rates of 2.22 percent and 1.60 percent, respectively. If variable-range, higher-ceiling depreciation rates proposed by El Paso are rejected, El Paso asks that Trial Staff's proposed depreciation rates for transmission and storage should be accepted,[144] in lieu of El Paso's existing depreciation rates.

96. However, El Paso makes clear that it does not endorse the depreciation testimony filed by Trial Staff in support of its proposed depreciation rates. In particular, El Paso argues that Trial Staff's witness did not present a true gas supply analysis. El Paso asserts that Trial Staff's witness did not attempt to forecast the time over which the resource base could be produced or to analyze the extent to which gas produced from various potential sources could be delivered to the transporter.[145]

<u>Commission Determination</u>

97. The Commission finds that the record supports the Presiding Judge's rejection of El Paso's proposal to establish a range of depreciation rates, along with a related compliance filing process. In particular, the Commission finds that the precedent cited by El Paso is misplaced, and the arguments for its proposal appear equivocal, vague, and poorly supported, leaving its existing depreciation levels as the only just and reasonable

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[142] Indicated Shippers Brief Opposing Exceptions at 13.

[143] *Id.* at 14 (citing El Paso Brief on Exceptions at 75).

[144] El Paso Brief Opposing Exceptions at 28.

[145] *Id.* at 29.

alternative that El Paso proffered at hearing. Accordingly, the Commission affirms the Presiding Judge's determination that El Paso adequately supported its existing mainline transportation and storage depreciation rates of 2.20 percent and 1.09 percent, respectively.

98. As the Presiding Judge states, El Paso attempts to support its depreciation range proposal through comparisons with the Commission's procedures for determining an ROE. However, these comparisons fall short. Most importantly, the Commission's procedure for selecting an ROE, while based on a range of reasonableness, does not involve adjusting the ROE in a later compliance filing to compensate a company for rulings by the Commission that reduce its cost of service on other cost elements. The Commission agrees that El Paso's proposal linking depreciation rates to other elements of the cost of service would effectively nullify appropriate discrete disallowances made by the Commission.

99. El Paso relies on the *Memphis* decision for its depreciation range proposal, where the court stated, "[w]e recognize that there is no one 'correct' depreciation rate; thus, the Commission could develop a range of rates which would fall within a 'zone of reasonableness.'"[146] However, nowhere does the court suggest that the Commission could adjust its selection of a depreciation rate within such a range based on rulings made by the Commission on other discrete parts of the cost of service. In the next paragraph, the court goes on to state that the Commission "establishes the proper depreciation rate for a particular natural gas company."[147]

100. The Commission rejects the notion that it should select a depreciation rate within a range of depreciation rates based on extraneous factors that are unrelated to the determination of a useful life of an asset. Finally, given its rejection of El Paso's depreciation range proposal, the Commission affirms the Presiding Judge's analysis that El Paso failed to support depreciation rates any higher than its existing 2.20 percent rate for mainline transportation plant and 1.09 percent for storage plant.

B. Depreciation Rate for Willcox Lateral (Stipulated Issue IV.B)

101. The Willcox Lateral, a 20-inch diameter lateral that stretches 56 miles from the South Mainline to the Mexican border in southeast Arizona, is the only facility on the El Paso system that provides incremental service. The Commission approved a 4.00 percent initial depreciation rate for the Willcox Lateral in its 2000 certificate

[146] *Memphis Light*, 504 F.2d 225, 234.

[147] *Id.*

proceeding.[148] El Paso filed to retain the 4.00 percent depreciation rate in the 2006 Rate Case proceeding, but the rate was reduced to 3.40 percent by settlement.[149] In the 2008 Rate Case proceeding, the 3.40 percent depreciation rate was maintained by settlement. In the current rate proceeding, El Paso again proposes to maintain the current 3.40 percent depreciation rate, and Trial Staff proposes that the depreciation rate should be lowered to the 2.20 percent mainline transmission depreciation rate.

Initial Decision

102. The Presiding Judge stated that El Paso proposed no change to the 3.40 percent Willcox Lateral depreciation rate, and that El Paso and Trial Staff appear to concur that Trial Staff bears the section 5 burden of proof regarding its proposal. However, the Presiding Judge rejected Trial Staff's proposal to impute the 2.20 percent mainline transmission depreciation rate to the Willcox Lateral. Specifically, the Presiding Judge found that Trial Staff failed to meet its section 5 burden to show that the current 3.40 percent depreciation rate is unjust and unreasonable and that its proposed 2.20 percent rate is just and reasonable.[150]

103. The Presiding Judge stated that the Commission has allowed depreciation rates based on contract terms for laterals and incremental facilities like the Willcox Lateral, which provide incremental service and have transportation rates that are incrementally derived and separately charged from mainline rates.[151] The Presiding Judge further stated that the record confirms that the Commission specifically required the Willcox Lateral's initial (certificated) depreciation rate to be derived on that basis.[152] The Presiding Judge found that Trial Staff's position is based only on its witness's assertion that he "believe[s]" the 2.20 percent transmission plant rate "is reasonable."

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[148] *El Paso Natural Gas Co.*, 90 FERC ¶ 61,126, at 61,383 (2000).

[149] 2006 Settlement, filed Dec. 6, 2006 in Docket No. RP05-422-000, Art. 3.2, App. C. The 3.40 rate was retained in the 2008 Rate Case Settlement, filed Mar. 11, 2010 in Docket No. RP08-426-000, Art. 3.2, App. G.

[150] ID, 139 FERC ¶ 63,020 at P 106.

[151] *Id.* P 104.

[152] *Id.* P 107.

Briefs on Exceptions

104. Trial Staff contends that the Presiding Judge ignores substantial evidence in the record that properly demonstrated that the existing Willcox Lateral depreciation rate of 3.40 percent is unjust and unreasonable. According to Trial Staff, a contract can give an indication of the minimum life of a company's facilities, but it should not take the place of a depreciation study to determine the remaining life of that company's facilities. Trial Staff does not contend that depreciation rates may never be based on contract life, but rather that the use of contract life is an exception to the general rule that is permitted only in very limited circumstances, which are not present here.[153]

105. Trial Staff argues that the Commission reaffirmed its general rule against using contract life in *Northwest* and in Opinion No. 486, and the only question is whether the Willcox Lateral depreciation rate falls within an exception to this rule.[154] Trial Staff points out that, in Opinion No. 486, the Commission explained that its decision to allow an exception to its general rule against allowing contract terms to be the basis for the depreciation rate was predicated on the fact that Kern River built facilities for specific customers and that those specific customers had entered into agreements obligating them to pay for the full costs of the facilities:

> [H]ere, as in *Northwest*, Kern River built facilities for specific customers. Those customers entered agreements that *obligated* them to pay for the full costs of the facilities. With respect to *High Desert*, the Commission specifically accepted the agreement and its associated recourse rate and book depreciation rate. The customers pay incremental rates for the Laterals so that the depreciation costs are not spread over other ratepayers. The *original* primary contracts are still in place. *In these circumstances*, the Commission sees no reason to disturb the arrangements of Kern River and the Lateral customers.[155]

106. In contrast to the circumstances in Opinion No. 486, Trial Staff contends that El Paso's Willcox Lateral shippers are not contractually obligated to pay the full cost of the

[153] Trial Staff Brief on Exceptions at 73-74.

[154] *Id.* at 74-75 (citing *Northwest Pipeline*, 87 FERC at 62,043; *Kern River*, Opinion No. 486, 117 FERC ¶ 61,077 at PP 487-488).

[155] *Id.* at 77 (citing Opinion No. 486, 117 FERC ¶ 61,077 at P 488) (emphasis added).

facilities during the term of their contracts. Trial Staff argues that *Northwest* is similarly distinguishable because the Commission's allowance of a depreciation rate based on contract life was in a case where two shippers had contractually agreed to pay the full cost of the facilities.

107. Therefore, Trial Staff asserts that the Presiding Judge's ruling on this matter is in error and should be reversed because it does not address the distinguishing fact that the Willcox Lateral customers never agreed to pay the full cost of the facilities in their contracts. Indeed, Trial Staff also points out that the fact that the Willcox Lateral contracts can be and have been renewed or extended and that new contracts have been entered into for these facilities further demonstrates that the Willcox Lateral depreciation rate should not be based on contract term.[156]

108. In support of the adoption of the mainline transmission depreciation rate for the Willcox Lateral, Trial Staff maintains that the 2.20 percent rate is based on recognized principles of supply, demand, competition, and interim retirements. Trial Staff also contends that its witness correctly determined the remaining economic life, average remaining life, and percent net plant for the Willcox Lateral, showing in the process that the current 3.40 percent rate is not just and reasonable. Further, Trial Staff argues that its witness presented a thorough and detailed analysis demonstrating why the existing mainline 2.20 percent depreciation rate is a reasonable and conservative depreciation rate for the Willcox Lateral. Therefore, Trial Staff states that the Commission should reverse the Presiding Judge's finding that Trial Staff failed to support its proposed 2.20 percent depreciation rate for the Willcox Lateral.[157]

Briefs Opposing Exceptions

109. El Paso asserts that the Presiding Judge correctly held that Trial Staff failed to meet its section 5 burden of showing that the existing 3.40 percent depreciation rate for the Willcox Lateral is unjust and unreasonable.[158] El Paso argues that Commission precedent indicates that contract life is a valid basis on which to derive depreciation rates for incremental facilities such as the Willcox Lateral. El Paso states that the Presiding Judge correctly observed that the Commission has in numerous cases authorized a

[156] *Id.* at 78-81.

[157] *Id.* at 85-90.

[158] El Paso Brief Opposing Exceptions at 32-35.

depreciation rate for incremental facilities, such as delivery laterals, based on contract life.[159]

110. El Paso also contends that Trial Staff overstates the Commission's reliance on "contractual" obligations and that other facts could warrant the use of contract life as a depreciation determinant. In the case of the Willcox Lateral, El Paso states that shippers agreed to pay the recourse rate established by the Commission, and the Commission required that the depreciation rate underlying such rate be derived from the weighted life of all non-contingent contracts. While El Paso acknowledges that the resulting depreciation rate of 4 percent was subsequently modified pursuant to FERC-approved rate settlements, it states that this alone does not mean that the current rate should be replaced by the even lower 2.20 percent mainline depreciation rate.[160]

111. In addition, El Paso objects to the argument that Trial Staff provided sufficient evidence to support the adoption of the mainline depreciation rate for the Willcox Lateral. El Paso argues that the Presiding Judge correctly found that the only justification offered by Trial Staff's witness in his direct testimony on the adoption of the mainline rate was the assertion that "[i]t is reasonable." El Paso points out that Trial Staff spends nearly four pages of its brief documenting the extensive remedial efforts made by its witness in his rebuttal testimony to discuss average remaining life (ARL) for the facilities, but that the discussion of ARL was superficial. El Paso states that he simply inferred that the Willcox Lateral exhibits the same remaining life characteristics as El Paso's mainline transmission plant and makes the assertion without performing any remaining life analysis for the Willcox Lateral.[161]

Commission Determination

112. The Commission reverses the Initial Decision and determines that the proper transmission depreciation rate for the Willcox Lateral is 2.20 percent. The Commission finds that Trial Staff met its NGA section 5 burden to show that the existing 3.40 percent depreciation rate is unjust and unreasonable. Trial Staff showed that the Willcox Lateral is not an exception to the Commission's general policy that contract term (or contract life) should not be used to establish depreciation rates. Specifically, pointing to Opinion No. 486 and *Northwest*, Trial Staff correctly argues that exceptions to the Commission's

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[159] *Id.* at 32 (citing *Northwest Pipeline,* 87 FERC ¶ 61,266; *Algonquin Gas Transmission, LLC*, 118 FERC ¶ 61,222 (2007); *Kinder Morgan Interstate Gas Transmission LLC*, 122 FERC ¶ 61,154 (2008)).

[160] *Id.* at 33.

[161] *Id.* at 34-35.

general policy are made only in those instances where customers have been obligated to pay the full cost of the facilities in the contract period.[162]

113. In contrast, El Paso's Willcox Lateral shippers are not contractually obligated to pay the full cost of the facilities during the term of their contracts. Rather, the Willcox Lateral contracts can be and have been renewed or extended. The Willcox Lateral has a transport design capacity of approximately 130,000 Mcf per day,[163] and on May 5, 2011, El Paso announced that it successfully added new contracts for 185,000 Dth/d of proposed expansion capacity in an open season, supported by 15-year contract commitments on its Willcox Lateral.[164]

114. The Presiding Judge stated that the Commission "required" the 4.00 percent rate in El Paso's 2000 Willcox Lateral certificate proceeding, implying that the Commission had previously ruled that contract term is an appropriate basis for its depreciation rate.[165] However, as pointed out by Trial Staff, the Willcox Lateral depreciation rate of 4.0 percent was an initial rate, which was subsequently reduced to 3.40 percent in two rate case settlements. This rate is under review here in a proceeding under sections 4 and 5 of the NGA,[166] and the facilities have now been in service for nearly 14 years. Indeed, Trial Staff reports two of the six initial 25-year term contracts have been extended several times.[167] Therefore, the depreciation rate for the Willcox Lateral should not be based on contract term, but rather on the economic life of the lateral facilities, which is directly tied to El Paso's mainline facilities.

115. Contrary to the Initial Decision, the Commission finds that Trial Staff supported the 2.20 percent rate for the Willcox Lateral as just and reasonable. The record in this case supports a finding that this rate is more appropriate than the 3.40 percent depreciation rate established by settlement in El Paso's prior two rate cases. For

[162] Trial Staff Brief on Exceptions at 77-78.

[163] Ex. S-8 at 5.

[164] Ex. S-9 at 1.

[165] ID, 139 FERC ¶ 63,020 at P 107.

[166] Trial Staff Brief on Exceptions at 79 (citing *Iroquois Gas Transmission Sys., L.P.* 84 FERC ¶ 61,086, at 61,438 (1998); *Tennessee Gas Pipeline Co.*, 81 FERC ¶ 61,224, at 61,949 (1997); *Blanco Oil Co. v. FERC*, 598 F.2d 152, 161 n.51 (D.C. Cir. 1979); *FPC v. Hunt*, 376 U.S. 515, 524 (1964)).

[167] *Id.* at 81.

example, El Paso states that its proposed 3.40 percent depreciation rate would result in the Willcox Lateral's net plant being fully depreciated in 20 years.[168] However, the physical facilities of the Willcox Lateral are nearly 60 years newer than those of El Paso's mainline facilities.

116. In addition, the remaining economic life study prepared by Trial Staff's witness demonstrates that the reserves in El Paso's supply areas can support production for at least 40 years.[169] From an economic standpoint, the same gas that supplies El Paso's mainline also supplies the Willcox Lateral. The fact that there have been new and renewed contracts indicates that there is ample demand for gas on El Paso's system. Therefore, the Commission finds that Trial Staff has met its section 5 burden to show that the existing 3.40 percent depreciation rate is unjust and unreasonable and that its proposed depreciation rate of 2.20 percent for the Willcox Lateral is just and reasonable.

C. Depreciation Rates for General and Intangible Plant (Stipulated Issue IV.C)

117. El Paso proposes to maintain the current general and intangible plant depreciation rates for 11 of the 13 sub-categories. For two sub-categories (Office Furniture and Office Equipment – FERC Account No. 391), El Paso proposes to increase the rate from zero to 10 percent. Indicated Shippers argue that El Paso is effectively applying a 12.4 percent weighted depreciation rate to general and intangible plant on a consolidated basis, which will allow it to realize full cost recovery in only two years, thereafter resulting in cost over-recovery. Indicated Shippers thus propose to apply a weighted 4.95 percent depreciation rate to intangible plant.

Initial Decision

118. The Presiding Judge rejected Indicated Shippers' proposal to apply a 4.95 percent weighted depreciation rate to consolidated general and intangible plant, which would spread the full cost recovery over five years. The Presiding Judge characterized Indicated Shippers' proposal as "unrealistic and unreasonable" because it effectively imputes the same useful life to all general and intangible plant assets, despite the fact that most (if not all) of the 13 general and intangible plant sub-categories have independently-determined useful lives.[170]

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[168] El Paso Brief Opposing Exceptions at 35 n.79.

[169] Trial Staff Brief on Exceptions at 63-64 (citing Ex. S-4 at 9, 17, 19-23).

[170] ID, 139 FERC ¶ 63,020 at P 110.

119. Therefore, the Presiding Judge found that it is just and reasonable for El Paso to continue to depreciate general and intangible plant on a 13 sub-category basis, given the wide variations in the expected useful lives of the various general and intangible plant assets. Moreover, based on the 2008 Rate Case Settlement, the Presiding Judge also found that it is appropriate for El Paso to re-commence depreciating Office Furniture and Office Equipment (FERC Account No. 391) at the 10 percent rate as the account balance is once again positive. At the time of the 2008 Rate Case Settlement, Account No. 391 was over-depreciated, and El Paso agreed to forego further depreciation until the account reflected a net positive balance.[171]

Briefs on Exceptions

120. Indicated Shippers contend that the Presiding Judge mistakenly assumed that their proposal applied to both general and intangible plant, when it actually applied only to the latter.[172] Indicated Shippers further argue that the Presiding Judge's acceptance of El Paso's claim of a 12.40 percent rate for intangible plant will result in an over-recovery of costs in two years. According to Indicated Shippers, the record shows that the intangible plant account has depreciated by $11.2 million from the original value of $14.9 million. That being the case, Indicated Shippers conclude that the remaining $3.7 million will be collected in two years unless the Initial Decision is reversed.[173]

Briefs Opposing Exceptions

121. El Paso contends that Indicated Shippers' proposal ignores the fact that different asset classes can be expected to have different useful lives. As the Presiding Judge stated, El Paso maintains that it makes no sense to presume computers and software have the same useful life as transportation equipment.[174]

122. El Paso also argues that Indicated Shippers' proposal to "combine and weight" the two different intangible plant accounts ignores the distinctly short useful life that computer software has due to technological obsolescence. El Paso points out that Indicated Shippers' proposal implies that El Paso needs to purchase *new software about*

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[171] *Id.* PP 109-110.

[172] Indicated Shippers Brief on Exceptions at 18 (citing Ex. IS-1 at 15-16).

[173] *Id.* at 17-18 (citing Ex. IS-1 at 16, lines 1-5).

[174] El Paso Brief Opposing Exceptions at 36 (citing ID, 139 FERC ¶ 63,020 at P 110).

once every 20 years.[175] In El Paso's view, the absurdity of their proposal is shown by the fact that El Paso has purchased an average of $3.3 million of new software each year since 2003 and must continue investing in new software while retiring obsolete software.

Commission Determination

123. The Commission finds that the evidence shows that the depreciation rates for the 13 subcategories of El Paso's plant assets reflect wide variations in the expected useful lives of these assets and that Indicated Shippers' weighted 4.95 percent rate ignores these circumstances, even in the application of such a weighted rate to only intangible plant. Specifically, the intangible plant includes separate depreciation rates for the sub-categories of Computer Software (15 percent) and Organization & Miscellaneous (4 percent).[176] Therefore, the Commission affirms the Presiding Judge's ruling that El Paso must continue to use the existing depreciation rates for general and intangible plant for 11 of the 13 subcategories of El Paso's plant assets. There was no challenge to El Paso's proposal to re-commence depreciating the other two subcategories (Office Furniture and Office Equipment in FERC Account No. 391) at a 10 percent rate.

D. Negative Salvage Rate for Transmission Plant (Stipulated Issue IV.D)

124. El Paso proposes to increase its current negative salvage rate from 0.12 percent to 0.18 percent.[177] Basing its proposal on an increase in retirement costs and declining salvage values, El Paso cites its experience over a five-year period from 2005 through 2009. Moreover, El Paso proposes to offset reductions in other elements of its cost of service by increasing the 0.18 percent figure up to a maximum of 0.23 percent. Trial Staff opposes any increase in the negative salvage rate. In addition, Trial Staff argues that El Paso's 0.23 percent contingent variable proposal should be rejected not only on its merits, but also on procedural grounds because it only arose at a late stage in the proceeding.

Initial Decision

125. The Presiding Judge found that El Paso failed to support a rate any higher than its currently-effective rate of 0.12 percent for negative net salvage. The Presiding Judge

[175] *Id.* at 36 (citing Ex. EPG-231 at 23-24 (emphasis in original)).

[176] *See id.* at 35-36 (citing Ex. EPG-159 at 16-17).

[177] Net salvage value is the salvage value of property retired less the cost of removal. 18 C.F.R., Part 201, Definition 23 (2013). The net is amortized and collected over the asset's useful life via a negative salvage rate.

agreed with Trial Staff that El Paso initially filed to increase its negative salvage rate from 0.12 to 0.18 percent, but after the original filing proposed the 0.23 percent contingent variable rate in its rebuttal testimony and exhibits.[178] The Presiding Judge quoted Commission regulations that specify that a natural gas pipeline filing for a change in rates or charges "must be prepared to go forward at a hearing and sustain, solely on the material submitted with its filing, the burden of proving that the proposed changes are just and reasonable."[179] Therefore, the Presiding Judge found that Commission regulations do not permit consideration of El Paso's 0.23 percent contingent variable rate. In addition, the Presiding Judge stated that there is no need to reiterate his previous criticisms and rejection of El Paso's contingent depreciation range and compliance filing proposals other than to state that they would be equally applicable to El Paso's proposal for negative net salvage.

126. Regarding its proposed increase to 0.18 percent, the Presiding Judge questioned El Paso's use of the most recent five-year period as the best indicator of current trends in plant retirements. Among other things, the Presiding Judge stated that El Paso did not explain why the most recent five-year period is the best indicator of an appropriate negative net salvage rate, nor did it specify any comparison periods to allow for analysis. Further, the Presiding Judge stated that a review of the 2005 through 2009 data does not support the asserted trend. The Presiding Judge concluded by finding that such small data sets may or may not be representative and that El Paso failed to satisfy its burden to prove that a 0.18 percent negative salvage rate is just and reasonable.[180]

127. The Presiding Judge also found that El Paso did not attempt to support a rate lower than 0.18 percent and that Trial Staff failed to support the current 0.12 percent negative salvage rate.[181] As a result, the Presiding Judge determined that the only potentially just and reasonable rates were the 0.10 percent (initial) rate implemented as a result of the 2006 Rate Case proceeding or the 0.12 percent (current) rate implemented as a result of the 2008 Rate Case proceeding. The Presiding Judge found that if either of those rates was implemented pursuant to a negative salvage rate-specific Commission determination/order, that rate must be continued here.[182]

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[178] ID, 139 FERC ¶ 63,020 at P 115.

[179] *Id.* (citing 18 C.F.R. § 154.301(c) (2013)).

[180] *Id.* P 116.

[181] *Id.* PP 117-118.

[182] *Id.*

Briefs on Exceptions

128. El Paso argues that the Presiding Judge erred in finding that El Paso was precluded from proposing a 0.23 percent negative net salvage rate based on updated test period data. El Paso states that its pre-existing negative salvage rate was 0.12 percent, and it sought an increase to 0.18 percent, and then submitted updated test period data supporting a rate of 0.23 percent.[183] El Paso asserts that updating cost of service data through the use of test period adjustments has been a fundamental part of setting just and reasonable rates at the Commission for decades. In support of its position, El Paso cites precedent stating that the Commission "has a clear policy preference that the determination of 'just and reasonable' rates be based on the most accurate and current information available within the test period."[184] El Paso adds that Commission regulations require test period adjustments in general NGA section 4 proceedings.[185] Therefore, states El Paso, its witness based his recommended negative salvage rate of 0.23 percent on actual per-books plant retirement costs incurred by El Paso for the 12 months ended March 31, 2011.

129. El Paso also argues that the Presiding Judge erred in finding that El Paso's data period was too limited and that the proposed negative salvage rate was not supported by data. On the contrary, contends El Paso, the period of 2005-2010 reflects the most recent available data and is the best indicator of current trends in the cost of plant retirements. Noting the Presiding Judge's reliance on the NARUC (National Association of Regulatory Utility Commissioners) manual (NARUC Manual), *Public Utility Depreciation Practices*, El Paso states that the language immediately preceding the referenced 20 or 30 year data band states, "*If the band is too long, it may mask any trend*."[186] El Paso asserts that its witnesses supplied substantial evidence supporting an upward trend of costs to decommission pipeline facilities in a safe and environmentally acceptable manner.[187]

130. Finally, El Paso argues that its proposed 0.18 percent negative salvage rate is supported within the five-year period and that the Presiding Judge ignored evidence

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[183] El Paso Brief on Exceptions at 81.

[184] *Id.* at 82 (citing *Williston Basin Interstate Pipeline Company*, 107 FERC ¶ 61,164, at P 67 (2004) (*Williston IV*)).

[185] *Id.* at 82-83 (citing 18 C.F.R. §§ 154.303(a), 154.312 (2013)).

[186] *Id.* at 84 (citing Ex. S-53 at 36 (emphasis added by El Paso)).

[187] *Id.* (citing Ex. EPG-16, Ex. EPG-231 at 20-21, Ex. EPG-249, and Ex. EPG-350 at 15-16).

showing that El Paso's cost of removal, net of salvage dollars, has substantially increased as a percent of plant retired over the last several years.[188]

Briefs Opposing Exceptions

131. Trial Staff contends that the Presiding Judge correctly denied El Paso's proposed increase of its negative salvage rate from 0.12 to 0.18 percent. Trial Staff states that El Paso failed to (1) explain why the most recent five-year period is the "best indicator" -- or even an adequate one; (2) specify any comparison period(s); or (3) illustrate any comparison(s).[189] Trial Staff argues that its witness showed that five years is not a sufficient period of time over which to obtain a sample for plant which, on a physical basis, can last for 65 years or more. Moreover, adds El Paso, no evidence was provided to support the continuation of the short-term trend over an extended period.[190]

132. Trial Staff states that the Commission has never approved a negative salvage rate for a pipeline based on five years of data in a litigated proceeding and that El Paso inappropriately relies on a case resolved by a settlement, which the Commission does not consider to be binding precedent.[191] Trial Staff also contends that the Presiding Judge appropriately relied upon the NARUC Manual *Public Utility Depreciation Practices,* which states that with respect to retirement activity, it is usually necessary to examine a wide band of years, perhaps 20 or 30 years.[192] Trial Staff explains that El Paso's facilities are long-lived property, which is consistent with the NARUC Manual and fully supports the Presiding Judge's conclusion that a five or six-year analysis is insufficient to support an increase in El Paso's negative salvage rate. In response to El Paso's argument that the Presiding Judge did not consider data it presented for 2011, Trial Staff asserts

[188] *Id.* at 85 (citing Ex. EPG-249 and Ex. EPG-231 at 20-21 (explaining that the cost of removal, net of salvage dollars, as a percent of plant retired was 14 percent in 2006, 13.6 percent in 2007, 28.5 percent in 2008, 16.3 percent in 2009 and 51 percent in 2010)).

[189] Trial Staff Brief Opposing Exceptions at 115 (citing ID, 139 FERC ¶ 63,020 at P 116).

[190] *Id.* at 116-17 (citing Ex. EPG-160, Ex. EPG-231 at 20-21, Ex. EPG-249, Ex. EPG-350 at 16-17, and Ex. EPG-355-57).

[191] *Id.* at 117-18 (citing Ex. S-45; *Tennessee Gas Pipeline Co.*, 137 FERC ¶ 61,182, at P 19 (2011)).

[192] *Id.* at 118 (citing Ex. S-53 at 36).

that a single year's data taken alone may or may not be representative and do not indicate a trend or adequately support the 0.18 percent negative salvage rate.[193]

133. Trial Staff also argues that El Paso incorrectly sought to increase its negative salvage rate up to a ceiling rate of 0.23 percent in its rebuttal testimony. Trial Staff states that the Presiding Judge was correct in rejecting El Paso's contingent variable proposal because the Commission generally relies on information submitted in the filing to prove that a proposed rate change is just and reasonable.[194] Trial Staff argues that, contrary to its assertions, El Paso did not just provide updated test period data, but rather proposed a completely new rate scheme, whereby it would select its negative salvage rate through a compliance mechanism to offset its reductions in its filed cost of service. Moreover, El Paso's contingent variable rate proposal was not offered until its rebuttal case, and the Presiding Judge correctly found it impermissible on that basis.

134. Finally, Trial Staff contends that El Paso's proposal suffers from the same defects evident with its variable depreciation rate proposal. The most significant of these defects is that it would allow El Paso to circumvent the Commission's rulings in this proceeding and reinstate its filed cost of service and/or rates.[195]

Commission Determination

135. The Commission affirms the Presiding Judge's ruling allowing El Paso to continue using its existing negative salvage rate of 0.12 percent. The Commission agrees with the Presiding Judge that El Paso failed to carry its burden to show that an increase to 0.18 is just and reasonable. In addition, the Commission agrees with the Presiding Judge's rejection of El Paso's contingent variable proposal on both procedural and substantive grounds.

136. On exceptions, El Paso argues that the Presiding Judge erred in rejecting its proposed increase to 0.18 percent. In El Paso's view, "[t]here is nothing in the record to suggest" that the five (or six) year period it relied on to support the 0.18 percent rate "is not representative or reliable."[196] However, it is El Paso's burden under NGA section 4

[193] *Id.* at 119.

[194] *Id.* at 113 (citing ID, 139 FERC ¶ 63,020 at P 115 and 18 C.F.R. § 154.301 (c) (2013)).

[195] *Id.* at 114.

[196] El Paso Brief on Exceptions at 84.

to demonstrate that the data on which it relied are representative – not that they may be representative.

137. Moreover, the Commission has never approved in a litigated proceeding a negative salvage rate for a pipeline based on five years of data. The NARUC Manual fully supports the Presiding Judge's conclusion that a five or six-year analysis is insufficient to support an increase in the negative salvage rate for El Paso's long-lived properties. While an analysis based on too long a period may mask an intermediate trend, as suggested by the NARUC Manual, the opposite is also true in the sense that too short a period can give too much weight to anomalous data and distort an accurate long-term trend assessment. El Paso failed to show that the recent short-term trend was likely to continue over the long term.

138. Regarding its contingent variable proposal, El Paso argues that the Presiding Judge "misapplied" the Commission's regulations to preclude it from increasing its negative salvage rate above the level proposed in its direct case.[197] According to El Paso, both the Commission's regulations and Commission precedent allow, if not require, data to be updated within the test period. El Paso states that its witness based his recommended negative salvage rate of 0.23 percent "on actual per books plant retirement costs incurred by [El Paso] for the twelve months ended March 31, 2011."[198]

139. However, while El Paso's cites are correct regarding the updating of information, its argument does not focus on the key issue. Specifically, El Paso did not merely propose a test period update in presenting its support for a rate as high as 0.23 percent in its rebuttal testimony. Rather, El Paso proposed a completely new system that would allow it to offset reductions in its filed cost of service directed by the Commission in this proceeding. In other words, El Paso changed its case-in-chief in its rebuttal testimony and thereby violated the Commission's regulations. Accordingly, the Commission affirms the Presiding Judge's holding that El Paso's variable negative salvage rate proposal suffers from the same defects as El Paso's variable depreciation rate proposal. Variable depreciation (or negative salvage) bands are novel concepts without precedent. Approving such "bands" for subsequent use outside the context of a general rate case (where all elements of a pipeline's operations are under review) could undermine the traditional ratemaking process by diffusing and diluting the Commission's decisions regarding each discrete element of the cost of service.

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[197] *Id.* at 82-83.

[198] *Id.* at 83.

V. Rate Base

140. The Stipulated Issues in this case include three issues related to rate base, which are discussed below. The sole exception is Stipulated Issue I.B (the level of accumulated deferred income tax (ADIT) attributable to the Willcox Lateral). The Presiding Judge stated that few parties address this issue, and they appear to agree that the appropriate amount of ADIT attributable to the Willcox Lateral is $2,831,264. Because no participant filed exceptions on this issue, the Commission summarily affirms the Initial Decision with respect to this issue. The remaining issues are discussed below, including Stipulated Issue I.A (the appropriate rate base treatment of the regulatory liability related to the FAS No. 106 Medicare Prescription Drug Subsidy) and Stipulated Issue I.C (the appropriate adjustments to plant-related accounts applicable to Line 1903).

A. FAS No. 106 Medicare Prescription Drug Subsidy (Stipulated Issue I.A)

Background

141. El Paso provides a prescription drug benefit similar to Medicare Part D to a closed and restricted class of retired employees, and the federal government directly reimburses El Paso for this benefit by means of the Medicare Prescription Drug Subsidy (Medicare Subsidy). El Paso administers the prescription drug benefit through a Voluntary Employees' Beneficiary Association (VEBA Trust) established in accordance with Commission policy[199] and the Statement of Financial Accounting Standard No. 106 (FAS 106). It is undisputed that the VEBA Trust assets are more than adequate to pay current obligations, so El Paso does not add the Medicare Subsidy reimbursements to the VEBA Trust, instead recording them (and associated accumulated deferred income tax (ADIT)) as a regulatory liability.

142. At hearing, Trial Staff and SoCal Gas/San Diego argued that the Medicare Subsidy and related ADIT should reduce El Paso's rate base. El Paso contended that it should not be treated in that manner.

Initial Decision

143. The Presiding Judge acknowledged that existing VEBA Trust assets are more than adequate to pay current obligations.[200] He observed that El Paso itself previously

[199] *Post-Employment Benefits Other Than Pensions*, 61 FERC ¶ 61,330 (1992), *order on reh'g*, 65 FERC ¶ 61,035 (1993) (*PBOP Policy Statement*).

[200] ID, 139 FERC ¶ 63,020 at P 20 (citing Ex. EPG-204 at 13; Ex. EPG-231 at 28-29).

endorsed crediting the liability to rate base, but chose not to do so in this proceeding, instead arguing that the VEBA Trust assets were adversely impacted by the 2008-2009 financial crisis. The Presiding Judge observed that a significant portion of the VEBA Trust assets were contributed during the 2002-2005 Capacity Allocation Proceeding time frame, and he stated that El Paso did not recover approximately $300 million in capacity reallocation value.[201] However, he ruled that the Medicare Subsidy and related ADIT should be used to reduce rate base. He found that there was no connection between El Paso's capacity allocation and the VEBA Trust funding, and he also found that El Paso failed to provide adequate support for its arguments.

Brief on Exceptions

144. El Paso contends that because it holds the Medicare Subsidy for the eventual benefit of retirees, it records a regulatory liability for the Medicare Subsidy amounts and the related ADIT amounts.[202] El Paso asserts that the Medicare Subsidy should not reduce rate base because (1) unlike most regulatory liabilities, the federal government, not ratepayers, funded the Medicare Subsidy; (2) ratepayers already receive a rate benefit from the Medicare Subsidy through a reduction in the FAS 106 expense included in El Paso's cost of service; and (3) ratepayers did not fully fund the VEBA Trust.[203] El Paso also cites its suggested alternative to reducing rate base, which would allow it to contribute the current net regulatory amount associated with the Medicare Subsidy of approximately $4 million into the VEBA Trust. El Paso maintains that it should be permitted to use the VEBA Trust to satisfy both the grandfathered retiree medical costs

[201] *Id.* P 19 (citing EPG-231 at 27-28; Ex. EPG-252).

[202] El Paso states that rate base-related ADIT represents an accumulation of the tax impact of differences in expense deductions or revenue recognition for book and tax purposes. Ex. EPG-257 at 10.

[203] El Paso argues that it effectively funded the VEBA Trust because most of the trust assets were contributed during the 2002-2005 time period when El Paso was precluded from recovering approximately $300 million as a result of the Capacity Allocation Proceeding. Ex. EPG-231 at 27; Ex. EPG-252. *See also Capacity Allocation Rehearing*, 104 FERC ¶ 61,045 at P 38. Although the Presiding Judge rejected El Paso's argument, finding that there was no nexus between the amount not recovered by El Paso and the contributions made during the time period in question, El Paso argues that there is no reason why such a precise nexus is necessary. According to El Paso, because it did not recover $300 million of its cost of service from ratepayers during 2002-2005, it cannot be concluded that El Paso's ratepayers funded the trust during that time period. Instead, states El Paso, because it did not recover its cost of service, it is most reasonable to assume that it contributed its own funds to the VEBA Trust.

and current employee welfare costs over time, in accordance with the tax and trust laws that exist at the time of such disbursements if the Commission permits it to contribute the funds to the VEBA Trust.

145. El Paso argues that the Medicare Subsidy differs from other funds such as ADIT that are provided by ratepayers and credited to rate base until the funds are needed to pay deferred taxes.[204] El Paso explains that it established a regulatory liability associated with the Medicare Subsidy because the funds were provided for retirees and ultimately would be used for the purposes of the VEBA Trust.[205]

146. El Paso further claims that the Presiding Judge erred by failing to find that El Paso's ratepayers already receive the benefit of the Medicare Subsidy. El Paso explains that the expense for the VEBA Trust is determined through the use of an actuarially-determined net periodic service cost,[206] and the net periodic service cost is reduced by a return on plan assets. Additionally, El Paso states that because the Medicare Subsidy increases the plan assets (for actuarial computational purposes only) and the return on those assets, the higher return also reduces the net periodic service cost.[207] Therefore, argues El Paso, the actuarially-determined FAS 106 expense level for the VEBA Trust in El Paso's cost of service is lower as a result of these past and future Medicare subsidy payments. El Paso maintains that it would be unreasonable for its ratepayers to benefit twice – once through reduced actuarially-determined expenses and again through a credit to El Paso's rate base for funds they have not provided.

147. El Paso points out that the Presiding Judge concluded that at most, El Paso credits ratepayers only a return on the Medicare Subsidy through the computation of the net

[204] El Paso Brief on Exceptions at 56 n.69 (citing *Public Systems v. FERC*, 709 F.2d 73, 83 (D.C. Cir. 1983) (Commission policy is to deduct ADIT from rate base to prevent utility from earning a return on funds contributed by ratepayers), *Enbridge Pipelines (KPC)*, 102 FERC ¶ 61,310, at P 69 (2003) (ADIT is capital supplied by ratepayers and must offset rate base to prevent ratepayers from paying a return on ADIT balances)).

[205] *See* Definition No. 31 in the Uniform System of Accounts. 18 C.F.R. Part 201 (2013).

[206] El Paso Brief on Exceptions at 56 (citing Ex. EPG-231 at 26).

[207] El Paso states that for actuarial purposes, plan assets are increased by the Medicare Subsidy that has been received and is expected to be received from the federal government. According to El Paso, net periodic service costs are based upon both a return on plan assets and expected payment to retirees. Ex. EPG-256 at 7.

periodic service cost.[208] However, El Paso contends that the return on the subsidy is the only rate element at issue, and a return of the Medicare Subsidy is not an issue because the Medicare Subsidy is not a cost and never has been recovered in El Paso's rates. Thus, continues El Paso, there is no subsidy "cost" to credit back to ratepayers, and the Presiding Judge erroneously ruled that ratepayers were entitled to both a return on and a return of the subsidy through a reduction in rate base.

148. Next, El Paso asserts that the Presiding Judge erred by rejecting its alternative proposal under which it would contribute the Medicare Subsidy to the VEBA Trust so that it could use the VEBA Trust for other employee welfare benefits. El Paso maintains that the fact that the VEBA Trust currently is over-funded is not a reason to reject its alternate proposal to fund the trust with the Medicare Subsidy.

149. El Paso also observes that the Presiding Judge found that it had provided inadequate evidentiary support for its alternative proposal and that it made no sense to add the subsidy to an already over-funded trust. However, El Paso argues that this conclusion ignores El Paso's testimony and the tax benefits of its alternative proposal.[209] El Paso explains that in the *PBOP Policy Statement*, the Commission required pipelines to maximize the use of tax deductions for post-retirement benefit contributions,[210] and El Paso asserts that its alternative proposal will minimize the taxes that ultimately will become due if and when El Paso is required to refund the contributions in the trust to ratepayers. Further, states El Paso, if the trust assets outlive the retired employees and El Paso makes refunds to ratepayers from the irrevocable trust, such refunds likely would be subject to excise taxes because the funds would not have been used for trust purposes.[211]

150. Finally, El Paso states that it cited two approved settlements that broadened the use of those pipelines' FAS 106 and 143 trusts in part to avoid the excise taxes that would apply if assets in the over-funded trust were returned to ratepayers.[212] El Paso contends that the same rationale should apply here, despite the fact that the previous cases addressed settlements.

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[208] El Paso Brief on Exceptions at 57 (citing ID, 139 FERC ¶ 63,020 at P 19 n.18).

[209] *Id.* at 58 (citing Ex. EPG-231 at 28-29).

[210] *Id.* (citing *PBOP Policy Statement*, 61 FERC ¶ 61,035 at 62,200).

[211] *Id.* at 58 n.77 (citing *Northern Natural Gas Co*., 135 FERC ¶ 61,124, at P 4 (2011) (*Northern Natural*), included in the record as Ex. EPG-254).

[212] *Id.* at 59 (citing Ex. EPG-231 at 29-30; Ex. EPG-253; Ex. EPG-254; Ex. EPG-255).

Briefs Opposing Exceptions

151. Trial Staff and SoCal Gas/San Diego contend that the Medicare Subsidy and related ADIT should be used to reduce El Paso's rate base. They point out that the VEBA Trust is fully funded, more than adequate to pay reasonably anticipated trust obligations, and in fact, is likely to have a surplus of money when El Paso's FAS 106 obligations end.[213] Trial Staff and SoCal Gas/San Diego argue that it is irrelevant that the federal government (rather than El Paso's ratepayers) provides the subsidy money.

152. Trial Staff and SoCal Gas/San Diego maintain that El Paso failed to support its argument that ratepayers already receive the benefit of the Medicare Subsidy through a reduction in the level of FAS 106 expense included in the cost of service.[214] Trial Staff explains that while the actuary does take into account the Medicare Subsidy payments by presuming that El Paso contributes those payments to the VEBA Trust, El Paso's ratepayers currently are not paying any FAS 106 expenses in rates because the trust is overfunded.[215]

153. SoCal Gas/San Diego emphasize that the reduction to which El Paso refers is a return <u>on</u> plan assets, not a return <u>of</u> the second payment of the double recovery.[216] SoCal Gas/San Diego maintain that the fact that El Paso assumes a return <u>on</u> the subsidy in determining the net periodic service cost is not the same as giving a one-for-one credit <u>of</u> the subsidy back to ratepayers. SoCal Gas/San Diego further point out that El Paso asserts that "a return *of* the Medical (sic) Subsidy is not an issue because the Medicare Subsidy is not a cost, and therefore has never been recovered in [El Paso's] rates. Thus, there is no subsidy 'cost' to credit back to ratepayers."[217] However, SoCal

[213] Trial Staff Brief Opposing Exceptions at 65 nn.187-188 (citing ID, 139 FERC ¶ 63,020 at P 20; Ex. EPG-204 at 13; Ex. EPG-231 at 28-30); SoCal Gas/San Diego Brief Opposing Exceptions at 6 (citing Ex. EPG-251 at 1).

[214] SoCal Gas/San Diego Brief Opposing Exceptions at 8 (citing El Paso Brief on Exceptions at 55).

[215] Trial Staff Brief Opposing Exceptions at 66 n.189 (stating that El Paso does not recover any FAS 106-related expenses in this case. Ex. EPG-231 at 26. El Paso receives the Medicare Subsidy in exchange for providing the retiree benefits, which it does through the VEBA Trust that is funded with ratepayer dollars. Ex. EPG-231 at 24-25).

[216] SoCal Gas/San Diego Brief Opposing Exceptions at 8 n.21 (citing El Paso Brief on Exceptions at 56-57; ID, 139 FERC ¶ 63,020 at P 22 n.18).

[217] *Id.* at 9 n.24 (citing El Paso Brief on Exceptions at 57 (emphasis in original)).

Gas/San Diego contend that the issue is not whether the Medicare Subsidy (or, more accurately, the benefit payments made to retired employees) is recorded as a cost, but whether El Paso is being paid twice for making the same benefit payments to its retired employees.

154. Trial Staff and SoCal Gas/San Diego support the Presiding Judge's determination that there is no connection between dollars El Paso allegedly was unable to recover in 2002-2005 and the funding of the VEBA Trust.[218] SoCal Gas/San Diego point out that the Presiding Judge observed that even if it were true that most of the VEBA Trust was funded between 2002 and 2005, El Paso failed to show that it withdrew those funds from capital rather than depositing revenues received from shippers.[219] In fact, continue SoCal Gas/San Diego, because El Paso's ratepayers funded the VEBA Trust, they should receive the benefit of the Medicare Subsidy.[220]

155. Trial Staff and SoCal Gas/San Diego further argue that the Commission should reject El Paso's alternative proposal to place the current net regulatory liability amount of $4 million (less the related ADIT) associated with the Medicare Subsidy into the VEBA Trust instead of reducing rate base.[221] SoCal Gas/San Diego contend that El Paso's alternative proposal comes too late and is not part of a settlement. SoCal Gas/San Diego assert that the Presiding Judge properly rejected it as untimely and inadequately supported.[222] Additionally, Trial Staff emphasizes that as the Presiding Judge found, contributions to the VEBA Trust, while ensuring that El Paso will not have the Medicare

[218] Trial Staff Brief Opposing Exceptions at 67 & n.191 (citing Ex. EPG-231 at 27-28). Trial Staff states that El Paso's Witness Dougherty merely testified that an exhibit provided in another case by another witness for another purpose and titled "Value of Capacity Used to Meet FR Shippers Needs" somehow "supports the conclusion that El Paso shareholders effectively contributed amounts into the trust." Additionally, Trial Staff emphasizes that Witness Dougherty does not say when and how much of the trust assets El Paso's shareholders actually furnished.

[219] SoCal Gas/San Diego Brief Opposing Exceptions at 8 (citing ID, 139 FERC ¶ 63,020 at P 20).

[220] *Id.* at 6 & n.11 (citing Ex. SCG-1 at 14:7-9).

[221] Trial Staff Brief Opposing Exceptions at 68 (citing El Paso Brief on Exceptions at 56, 58-59).

[222] SoCal Gas/San Diego Brief Opposing Exceptions at 9-10 (citing ID, 139 FERC ¶ 63,020 at P 20 n.19).

Subsidy for its own use, nonetheless makes little sense because the trust is already fully funded.[223]

156. Finally, Trial Staff asserts that El Paso's proposal to reduce the subsidy to reflect ADIT before placing the subsidy into the VEBA Trust is erroneous because ADIT relates to taxes on income. Trial Staff explains that if El Paso places the subsidy into the VEBA Trust rather than retaining it as income, there will be no associated income and thus no associated ADIT. Therefore, continues Trial Staff, there is no need to make an adjustment to the subsidy amounts contributed to the VEBA Trust for ADIT. Trial Staff asserts that an adjustment to ADIT is required only to the extent that El Paso retains the subsidy as income and also is required to reflect the subsidy in rate base in this case.[224] If the Commission accepts El Paso's alternative proposal to contribute the annual subsidy to the VEBA Trust, Trial Staff asserts that the Commission should order El Paso to contribute the annual amount that it receives from the federal government – and not something less.

Commission Determination

157. The Commission affirms the Presiding Judge's ruling on this issue. The Presiding Judge evaluated the evidence and determined that the Medicare Subsidy and related ADIT should reduce El Paso's rate base. There is no dispute that the federal government funds the Medicare Subsidy expense and that El Paso's ratepayers do not pay those costs. However, El Paso's ratepayers previously funded the VEBA Trust in accordance with the Commission's policies,[225] and the trust currently is more than sufficient to meet its reasonably expected obligations. Moreover, the Presiding Judge concluded that no nexus existed between El Paso's claimed loss of capacity value as a result of its Capacity

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[223] Trial Staff Brief Opposing Exceptions at 68 n.193. Trial Staff states as follows:

> Regarding [El Paso's] request to expand the trust beneficiaries to include other unspecified employee welfare beneficiaries, such a request seems to be seeking broad discretionary authority for [El Paso.] Instead, Trial Staff recommends that [El Paso] seek authority, similar to that approved in the Northern Natural Gas Company settlement in Docket Nos. RP03-358 and RP04-155, to apply excess FAS 106 funds to specific and comparable programs. [*Northern Natural*, 135 FERC ¶ 61,124]; Ex. EPG-231 at 28-29; Ex. EPG-253 and Ex. EPG-254.

[224] *Id.* at 68 (citing Ex. EPG-250).

[225] *PBOP Policy Statement,* 61 FERC ¶ 61,330, *order on reh'g,* 65 FERC ¶ 61,035.

Allocation Proceeding and trust contributions made during that time period, despite El Paso's assertion that it could be presumed to have funded the VEBA Trust from its own funds. At any rate, if such a nexus exists, the Presiding Judge found that El Paso had not substantiated that claim. Accordingly, the Commission affirms the Initial Decision and will require El Paso to reduce its rate base by the amount of the Medicare Subsidy and related ADIT. Because El Paso's ratepayers funded the VEBA Trust, they are entitled to the financial benefit of the Medicare Subsidy, and El Paso may not retain it for the benefit of its shareholders.

158. Additionally, the Commission finds that the Presiding Judge properly rejected El Paso's alternative proposal under which it would contribute the Medicare Subsidy to the VEBA Trust and would use the trust for other employee benefits. As stated above, the VEBA Trust is over-funded, and for that reason, it makes little sense to contribute the Medicare Subsidy to the trust. The Presiding Judge pointed out that El Paso had not chosen to contribute the Medicare Subsidy to the VEBA Trust at any time since the trust was established, and in any event, the Presiding Judge concluded that El Paso had failed to provide adequate support for the alternative proposal. While El Paso cites settlements in support of its proposal to expand the application of the VEBA Trust to include other employee benefits,[226] these settlements do not constitute binding precedent that would compel a similar decision here for these expenses.[227]

B. Rate Base Amounts Related to Line 1903 (Stipulated Issue I.C)

159. In March 2000, El Paso purchased a 1,088-mile crude oil pipeline from All American Pipeline Company (All American) for $129.3 million. El Paso planned to convert this line to natural gas transportation service. In 2001, El Paso received Commission authorization to convert a 785-mile segment of the pipeline (Line 2000) to natural gas service, using a mileage-based cost allocation methodology to allocate $93.1 million of the purchase price to the Line 2000 facilities on a rolled-in basis.[228] In 2005, El Paso received certificate authority to convert a second segment of the All American pipeline, the 88-mile Line 1903.[229] The Commission granted El Paso a predetermination

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[226] El Paso Brief on Exceptions at 58 (citing *Northern Natural*, 135 FERC ¶ 61,124).

[227] *See, e.g., Entergy Services, Inc.*, 108 FERC ¶ 61,238, at P 2 (2004).

[228] *El Paso Natural Gas Co.*, 95 FERC ¶ 61,176 (2001) (*Line 2000 Certificate Order*).

[229] *El Paso Natural Gas Co.*, 111 FERC ¶ 61,408, *reh'g denied*, 113 FERC ¶ 61,183 (2005), *reh'g denied*, 115 FERC ¶ 61,083 (2006) (*Line 1903 Certificate Order*).

of rolled-in rate treatment of $10.5 million for Line 1903, again using the mileage-based cost allocation methodology. El Paso requested that the Commission defer a finding with respect to the recovery of the remaining $25.7 million related to the unused 215-mile California segment of the All American pipeline until its next rate case.

160. In Opinion No. 517,[230] the Commission determined that El Paso may not recover the $25.7 million in costs associated with the California segment of the All American pipeline and that El Paso had not demonstrated a need to adjust its depreciable plant accounts to reflect the exclusion. The Commission found that (1) El Paso's depreciable plant account should include only the $10.5 million associated with El Paso's investment in Line 1903, and (2) El Paso had not shown that it had booked accumulated depreciation and ADIT assessed on the unused California segment that El Paso purchased along with Line 1903.[231]

161. In this proceeding, El Paso argues that if the Commission decides that it cannot roll in the entire costs of Line 1903, it must be allowed to adjust its depreciation and ADIT accounts to remove the effects of excluding the $25.7 million in rate base. Trial Staff and Texas Gas Service argue that no adjustment to the depreciation and ADIT accounts is necessary because the purchase price should not have been included in rate base.

<u>Initial Decision</u>

162. To avoid relitigating issues, the Presiding Judge did not address this issue except to state that the issue was resolved in Opinion No. 517.[232]

<u>Briefs on Exceptions</u>

163. El Paso argues that the Presiding Judge erred by failing to determine the appropriate amount of plant account adjustments relating to the disallowance of a part of the purchase price of Line 1903. El Paso states that it has requested rehearing of Opinion No. 517 with respect to the rulings that (1) $25.7 million of the Line 1903 purchase price should be removed from rate base in the 2008 Rate Case[233] and (2) El Paso failed to

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[230] Opinion No. 517, 139 FERC ¶ 61,095.

[231] *Id.* PP 44-52.

[232] ID at P 23 (citing Opinion No. 517, 139 FERC ¶ 61,095 at PP 44-52).

[233] El Paso Brief on Exceptions at 60 (citing Opinion No. 517, 139 FERC ¶ 61,095 at P 44).

provide evidence showing that it had booked accumulated depreciation and ADIT on the excluded segment and therefore that El Paso was not allowed to make corresponding adjustments to its plant-related accounts.

164. El Paso states that in Opinion No. 517, the Commission did not permanently resolve the issue, but found that no adjustment was necessary "at this time" because the record was not clear about El Paso's depreciation and ADIT related to the excluded segment. El Paso contends that in the instant proceeding, it is clear that the adjustments to ADIT and accumulated depreciation are required. El Paso argues that Ex. EPG-231 clearly shows that El Paso had recorded on its FERC books and records, from December 2005 through the end of the test period, depreciation and ADIT associated with the $25.7 million excluded from rate base. El Paso asserts that no participant disputed these amounts, and SoCal Gas/San Diego, which challenged many of El Paso's rate base and cost of service proposals, agreed with the amount of the adjustments.[234] El Paso states that Trial Staff was the only other participant to address the issue, and that it did not oppose the proposed adjustment to ADIT in either testimony or briefs. El Paso asserts that its accounting records, as confirmed by Trial Staff's Witness Steen's own exhibits, show that El Paso placed the full $36.2 million purchase price into gas plant in December 2005 and continued to depreciate this entire amount through the end of the test period in this case. In sum, El Paso argues that there is no reason to deny it the proposed adjustments to ADIT and accumulated depreciation related to Line 1903.

Briefs Opposing Exceptions

165. Trial Staff argues that El Paso should not be permitted to adjust rates for the accumulated depreciation and ADIT associated with the Commission's disallowance of part of the purchase price of Line 1903.[235] Trial Staff contends that El Paso's argument that the accumulated depreciation and ADIT adjustments relating to the $25.7 million Line 1903 were recorded on its books, thereby justifying El Paso's recovery of those costs from ratepayers, has no merit. Trial Staff states that in support of its allegation, El Paso can point only to a spreadsheet showing the $3.1 million and $3.3 million adjustments to rate base. Trial Staff emphasizes that the evidence does not show that El Paso is entitled to make a rate adjustment for the $25.7 million Line 1903 investment when that investment was not and could not have been in rate base.[236] Trial Staff asserts

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[234] El Paso Brief on Exceptions at 60-61 (citing SoCal Gas/San Diego Reply Brief at 6).

[235] Trial Staff Brief Opposing Exceptions at 69-71.

[236] *Id.* at 71 (citing Ex. EPG-300, which calculates the difference between what El Paso would have booked for a Line 1903 investment of $36.2 million as opposed to a Line 1903 investment of $10.5 million).

that El Paso should not be allowed to reflect in rates any adjustments for accumulated depreciation and ADIT to plant that has not been in service and has not been in rate base.

166. Texas Gas Service argues that the Commission should reject El Paso's proposed accounting adjustments relating to Line 1903 because the Commission made it clear that El Paso had the burden of providing evidence before it could adjust the depreciable plant accounts to exclude the $25.7 million. Texas Gas Service contends that the Commission should reject the accounting adjustments because El Paso did not demonstrate that any adjustments will place its ratepayers in no worse position than if El Paso had not overstated its rate base by $25.7 million.[237]

Commission Determination

167. In Opinion No. 517, the Commission denied El Paso's request to adjust the depreciable plant accounts to reflect the exclusion of $25.7 million because it found that El Paso had provided no evidence to show that it had booked ADIT assessed on the California segment of the All American pipeline and that no adjustment was necessary "at this time." Further, in the 2008 Rate Case Settlement, the parties agreed that resolution of issues relating to Line 1903 will not affect the rates established in Opinion No. 517. Thus, there was no rate consequence from the Commission's determination in Opinion No. 517 that El Paso had not adequately supported depreciation and ADIT adjustments associated with the $25.7 million excluded from rate base.[238] Nevertheless, contrary to Texas Gas' suggestion, the Commission voiced its expectation that El Paso's accounting should accurately reflect the circumstances on its system, stating: "El Paso's depreciable plant balance should reflect El Paso's end of test period actual book amounts, adjusted to include only the $10.5 million associated with El Paso's investment in Line 1903."[239] El Paso's rates filed in the compliance phase of this proceeding should be adjusted to the extent needed to ensure that the compliance rates do not reflect costs or accounting stemming from the fact that El Paso originally proposed to include costs attributable to the unused California segment – costs that were rejected in Opinion No. 517.

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[237] Texas Gas Service Brief Opposing Exceptions at 92-93.

[238] Opinion No. 517, 139 FERC ¶ 61,095 at P 51.

[239] *Id.* P 52.

C. Tucson and Deming Compressor Station Abandonment Costs (Stipulated Issue V)

168. On September 28, 2010 (within the test period), El Paso applied to abandon in place the Tucson and Deming Compressor Stations (Abandonment Application).[240] Two days later, El Paso filed the instant rate case, including in its filed cost of service approximately $1.1 million as the annual impact of the compressor stations.[241] El Paso requested Commission approval of its Abandonment Application by March 31, 2011, the end of the test period. On September 15, 2011, the Commission issued the Order Approving Abandonment (*Abandonment Order*).[242] In the *Abandonment Order*, the Commission stated that the effect of the abandonment on El Paso's throughput and any potential savings associated with the abandonment are the subject of the 2011 Rate Case proceeding.[243]

169. El Paso argued at hearing that, although the Tucson and Deming Compressor Stations were not operated significantly during the test period, they continued to provide operational flexibility and reliability. As a consequence, El Paso contended that these facilities remained used and useful at least through March 31, 2011, and their associated plant (rate base) and O&M costs should be reflected in the rates approved in this proceeding. Trial Staff asserted that El Paso's cost of service should be based on its actual test period costs, but if the Commission were to permit El Paso to include the Tucson and Deming Compressor Station costs in its cost of service, the Commission also should include cost decreases occurring outside the test period. Indicated Shippers and SoCal Gas/San Diego asserted that any costs associated with these stations should be excluded from El Paso's cost of service.

Initial Decision

170. The Presiding Judge found that it would be unjust and unreasonable for El Paso to include in its cost of service any expenses associated with the Tucson and Deming

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[240] Application of El Paso Natural Gas Company for Permission and Approval to Abandon, Docket No. CP10-510-000 (September 28, 2010).

[241] *See* ID, 139 FERC ¶ 63,020 at P 119 & n.114 (noting El Paso's voluntarily $20 million reduction to cost of service that it claimed reflected "in small part" estimated cost savings attributable to the abandonments; citing Ex. EPG-293 at 17).

[242] *El Paso Natural Gas Co.*, 136 FERC ¶ 61,180 (2011) (*Abandonment Order*), *order granting clarification*, 138 FERC ¶ 61,215 (2012).

[243] *Abandonment Order*, 136 FERC ¶ 61,180 at P 27 & n.11.

Compressor Stations because they will not be used and useful during the period when the rates will be in effect. He pointed out that the Commission approved the Abandonment Application on September 15, 2011, and in fact, the stations have been abandoned.[244]

171. The Presiding Judge further found that, although the Commission approved the Abandonment Application after the test period, that fact is not controlling. He stated that including these facilities in El Paso's rates would defeat a fundamental purpose of test period ratemaking: to establish a representative going-forward cost of service. In addition, the Presiding Judge cited El Paso's statements in its Abandonment Application, in which it expressly represented that the abandonment would benefit shippers by eliminating unnecessary annual maintenance costs attributable to the facilities and that any rate impact of the abandonment should be reflected in the rate case filing in this proceeding.[245]

172. The Presiding Judge determined that the *Abandonment Order* reasonably may be deemed to relate back to the September 28, 2010 Abandonment Application date for ratemaking purposes. The Presiding Judge emphasized that El Paso filed the Abandonment Application within the test period and that it acknowledged that the stations were functionally obsolete and no longer required to provide service as of the date of the Abandonment Application.[246] He also pointed out that El Paso affirmatively represented in its rate case filing that the two compressor stations would not be reflected in the rates requested in this proceeding if the Commission approved the Abandonment Application. Accordingly, the Presiding Judge ruled that El Paso could not disclaim the responsibility it assumed by relying on the technicality that the Commission did not approve the Abandonment Application by March 31, 2011. The Presiding Judge determined that El Paso must exclude from its cost of service any expenses associated with the Tucson and Deming Compressor Stations.

Briefs on Exceptions

173. El Paso argues on exceptions that the Presiding Judge erred by refusing to allow it to include in its cost of service rate base and related expenses for the two compressor

[244] ID, 139 FERC ¶ 63,020 at P 125 (citing notices of abandonments filed Dec. 22 and Dec. 27, 2011 in *El Paso Natural Gas Co.*, Docket No. CP10-510-000).

[245] *Id.* (citing Ex. SCG-56 at 15).

[246] *Id.* (citing Ex. EPG-298 at 4, 9 & n.115). The Presiding Judge stated that, because the "used and useful" standard is conjunctive, it is insufficient that the stations may have been held in reserve (i.e. used) as emergency redundancy facilities during/throughout the test period.

stations. El Paso emphasizes that it did not abandon the facilities until December 2011, following the September 15, 2011 issuance of the *Abandonment Order*.

174. El Paso further contends that the Presiding Judge's decision is inconsistent with Commission precedent establishing that test period costs and billing determinants are presumptively just and reasonable. El Paso also asserts that the Commission's strong preference is to use the rate base existing on the last day of the test period.[247] Moreover, continues El Paso, it is irrelevant that the effects of the abandonment may be known during the test period if it was not known when or if those effects will occur.[248]

175. El Paso states that, while the Presiding Judge seemed to agree that the stations were used during the test period, he erroneously stated that they were not useful during that period. El Paso claims that the stations were useful because they continued to provide operational flexibility and reliability during the test period. El Paso argues that Commission precedent establishes that the costs of a compressor station held in reserve or to ensure operational reliability may be included in pipeline rates.[249] Moreover, adds El Paso, although it conceded in its Abandonment Application that the stations were functionally obsolete, that should not be seen as a concession that the stations would not continue to perform a useful function for firm and interruptible ratepayers until abandonment. El Paso claims that the Commission has allowed the costs of facilities abandoned after the test period to be included in rates.[250] Further, states El Paso, the cases it cites are consistent with the long-standing principle that new construction that is known but not yet in service may not be reflected in rates.[251]

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[247] El Paso Brief on Exceptions at 89 (citing *Panhandle I*, Opinion No. 404, 74 FERC at 61,354).

[248] *Id.* at 90 n.110 (citing *Northwest Pipeline*, 87 FERC at 62,051-55 (refusing to lower an annual revenue credit attributable to contracts that terminated due to a post-test period abandonment)).

[249] *Id.* at 90-91 & n.112 (citing *Wyoming Interstate Company, Ltd*., 76 FERC ¶ 61,252, at 62,308 (1996) (*Wyoming Interstate*); *see also Eastern Shore Natural Gas Co*., 76 FERC ¶ 61,358, at 62,677, 62,680 (1996) (*Eastern Shore*); *cf. Great Lakes Gas Transmission Limited Partnership*, 74 FERC ¶ 61,171, at 61,597 (1996) (*Great Lakes*)).

[250] *Id.* at 92 (citing *Panhandle Eastern Pipe Line Co*., Opinion No. 395, 71 FERC ¶ 61,228, at 61,825 (1995) (*Panhandle II*); *Tennessee Gas Pipeline Co*., 73 FERC ¶ 61,368 (1995)).

[251] *Id.* at 92-93 (citing 18 C.F.R. § 154.303(c)(2) (2013); *Florida Gas Transmission Company, LLC*, 130 FERC ¶ 61,250, at PP 43-45 (2010)).

176. Finally, El Paso asserts that the Presiding Judge erred by concluding that it represented in its Abandonment Application and its rate case filing that it would not reflect the costs of the stations in its rates in this proceeding. El Paso also argues that it explicitly declined to commit to removing those costs from its cost of service in this proceeding should abandonment not occur before the end of the test period. According to El Paso, it stated in the Abandonment Application that any rate impact to consumers resulting from a "timely" approval should be reflected in the instant rate case filing.[252]

Briefs Opposing Exceptions

177. Indicated Shippers emphasize that it is undisputed that the compressor stations are not currently used and useful to provide jurisdictional transportation service. Thus, state Indicated Shippers, the only question remaining is whether the Commission has the authority to go beyond the test period to require El Paso to remove the rate base and costs related to the stations. Citing *National Fuel Gas Supply Corp.*,[253] Indicated Shippers argue that the Commission has the authority to require removal of the rate base and costs related to these facilities, despite the fact that the abandonment was not authorized until after the close of the test period. Indicated Shippers maintain that including such costs and rate base in the rates at issue in this proceeding would be an unreasonable result that warrants going beyond the test period.

178. SoCal Gas/San Diego also cite El Paso's statements that the two stations had become functionally obsolete and no longer were required to provide transportation service.[254] They further cite El Paso's expressed desire to benefit its customers[255] and its acknowledgement that the stations were not operated in recent years except as necessary

[252] *Id.* at 93 (citing Ex. EPG-298 at 15 of 37; Ex. EPG-177 at 17, II. 19-22).

[253] Indicated Shippers Brief Opposing Exceptions at 15-16 (citing *National Fuel Gas Supply Corp.*, 51 FERC ¶ 61,122, at 61,334 (1990) (*National Fuel*) (citing *Papago Tribal Utility Auth. v. FERC*, 773 F.2d 1056, 1063 (9th Cir. 1985) (noting that courts have given the Commission latitude to determine whether to adopt or reject actual data from the test period and deciding that the Commission did not abuse this discretion when it adjusted test period estimates to include the effects of the unforeseen sale of a steam generating plant)).

[254] SoCal Gas/San Diego Brief Opposing Exceptions at 11-12 (citing Ex. EPG-298 at 4).

[255] *Id.* at 12 (citing Ex. EPG-298 at 7).

to maintain compliance with the requirements of the U.S. Department of Transportation (DOT) and the Environmental Protection Agency (EPA).[256]

179. SoCal Gas/San Diego point out that the *Abandonment Order* was issued the day before El Paso filed it rebuttal testimony in this case, in which El Paso continued to include the rate base and costs related to the two stations. They contend that the Presiding Judge fully justified the exclusion of the stations from rate base and operating costs based on El Paso's own representations that the stations were functionally obsolete and no longer required to provide service. According to SoCal Gas/San Diego, the Presiding Judge also properly found that the abandonment may be deemed to relate back to the September 28, 2010 date of the Abandonment Application.

180. SoCal Gas/San Diego point out that, unlike any other test period cost or expense, El Paso itself identified these two compressor stations for removal from cost of service and rate base, and the *Abandonment Order* recognized that the potential savings resulting from the abandonment are at issue in the pending rate case. According to SoCal Gas/San Diego, El Paso's assertion that the stations were available as reserve units during the test period means only that they were required to be maintained as operational until abandoned, not that they were used and useful during the test period.

181. SoCal Gas/San Diego argue that *Northwest* is distinguishable on the facts.[257] SoCal Gas/San Diego state that, in that case, the pipeline had not entered into the contract for the sale of the facilities in question until after it made its rate case filing.[258] SoCal Gas/San Diego also observe that, unlike El Paso, Northwest had not made any representations in its rate case filing that the cost savings from the facilities in question would be reflected in the rates set in the rate case. SoCal Gas/San Diego state that the Commission affirmed the initial decision's determination not to recognize the post test period charge.[259]

182. Moreover, continue SoCal Gas/San Diego, Opinion No. 395[260] did not involve an abandonment order, instead relating to a claim by some shippers that certain compression facilities had been moth-balled, not abandoned under the authority of a Commission

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[256] *Id.* (citing Tr. 2222:3-2223:9 (Westhoff test.)).

[257] *Id.* at 14 (citing *Northwest Pipeline,* 87 FERC ¶ 61,266).

[258] *Id.* (citing *Northwest Pipeline*, 87 FERC at 62,051).

[259] *Id.* (citing *Northwest Pipeline,* 87 FERC ¶ 61,266 at 62,055).

[260] *Id.* at 15 (citing *Panhandle II,* Opinion No. 395, 71 FERC ¶ 61,228).

order. In that case, state SoCal Gas/San Diego, the Commission found the evidence that the compressors were not used for the last three months of the test period to be insufficient to conclude that they were not used and useful during the limited time period of the first of two pancaked cases filed by the pipeline.[261]

Commission Determination

183. The Commission affirms the Presiding Judge's determination requiring El Paso to exclude from its cost of service the costs related to the abandoned Tucson and Deming Compressor Stations.

184. In *National Fuel*, the Commission stated as follows:

> The Commission has discretion whether to use actual base year or test period data or to adjust these estimates for post-period data. The Commission has made exceptions to its adherence to the test period concept where there are known and measurable changes of a substantial nature. Exceptions are warranted if subsequent events indicate that the test period estimates were substantially in error or would yield unreasonable results.[262]

185. El Paso's Abandonment Application is replete with statements reflecting El Paso's intent to abandon the Tucson and Deming compressor stations because they were obsolete and served no function in the transportation of natural gas.[263] El Paso also stated repeatedly that the abandonment would not affect service to current or anticipated customers,[264] that the facilities had been operated and maintained only as necessary to meet regulatory requirements,[265] that they created unnecessary costs for ratepayers,[266] and that the cost reduction should be reflected in future rates.[267]

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[261] *Id.* (citing Opinion No. 395, 71 FERC at 61,825).

[262] *National Fuel.*, 51 FERC at 61,334 (footnotes omitted).

[263] Abandonment Application at 1, 4, 5, 6, 7, 12.

[264] *Id*. at 6, 7, 8, 9, 10, 13.

[265] *Id.* at 6, 7.

[266] *Id.* at 7, 12, 13.

[267] *Id.* at 4 n.5, 12.

186. In light of these statements and El Paso's actual abandonment of the two compressor stations in 2011, its arguments that it should be allowed to retain the Tucson and Deming compressor stations in its rate base and cost of service for purposes of this proceeding have no merit. While El Paso correctly points out that the *Abandonment Order* and the actual abandonment of the facilities occurred after the close of the test period, it likewise does not dispute that these compressor stations have not served any real function related to the transportation of natural gas for a number of years and in fact were operated only for the purpose of meeting regulatory requirements.

187. The cases cited by El Paso do not require a different result. For example, in Opinion No. 404, the Commission affirmed an initial decision allowing the pipeline to retain in its rate base certain facilities sold after the test period, pointing out that the sales and automatic abandonment were of a routine nature for the pipeline.[268] Similarly, in *Northwest*, the pipeline did not enter into the contract for sale of the facilities until after it filed its rate case.[269] In contrast, the instant case involves an abandonment and related cost savings that El Paso anticipated when it filed the Abandonment Application in advance of the rate case filing.

188. El Paso also cites Opinion No. 395, but that case too is distinguishable. While the Commission permitted certain compressors to remain in the pipeline's rate base, the Commission stated that the "rate period" ran from April 1, 1992 through October 31, 1992, and the Commission found evidence that the compressors were not used from August 1, 1992 through October 31, 1992. However, the Commission found no evidence that they were not used prior to August 1, 1992.[270] In the instant case, it is clear that the Tucson and Deming Compressor Stations were not used for natural gas transportation for a number of years prior to El Paso's application to abandon those facilities.

189. Other cases cited by El Paso were certificate proceedings involving proposed new construction that would improve the pipelines' service and reliability.[271] Those cases involving proposed facilities are easily distinguishable from the facts in the instant rate proceeding, in which El Paso seeks to include the costs of facilities that it has abandoned.

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[268] *Panhandle I,* Opinion No. 404, 74 FERC at 61,354.

[269] *Northwest Pipeline*, 87 FERC at 62,051-62,055.

[270] *Panhandle II,* Opinion No. 395, 71 FERC at 61,824-61,825.

[271] *Great Lakes*, 74 FERC at 61,596-61,597; *Wyoming Interstate*, 76 FERC at 62,308-62,309; *Eastern Shore*, 76 FERC at 62,677, 62,680.

190. Accordingly, the Commission will affirm in part the Presiding Judge's determination requiring El Paso to exclude from its cost of service the costs related to the abandoned Tucson and Deming Compressor Stations, consistent with the reservation of this issue for ratemaking purposes in the abandonment proceeding. It would be unjust and unreasonable to include the costs of those facilities in the rates established in this proceeding. However, the Commission modifies the Initial Decision to make the Commission's ruling on this issue effective as of the date of the *Abandonment Order*, September 15, 2011.

VI. Rate Design

A. Billing Determinants and Revenue Credits (Stipulated Issues VI.A, VI.B, VI.C)

El Paso's Proposal

191. At hearing, El Paso proposed to determine reservation billing determinants for non-Article 11.2 rates using contract volumes in effect on March 31, 2011, adjusted to annualize the volumes and reflect its proposed discounting adjustment.[272] For the Article 11.2 reservation quantities, El Paso proposed to use the annual average contract volumes as of March 31, 2011.[273]

192. To determine usage billing determinants for non-Article 11.2 rates, El Paso proposed to average the actual monthly volumes in January through March 2011 and annualize the result.[274] El Paso proposed to credit Article 11.2 usage revenues to the cost of service based on the average and annualized volumes for the months of January through March 2011.[275]

193. El Paso proposed cost of service revenue credits for Authorized Overrun transactions (AOR), Interruptible Hourly Swing Service (IHSW), and Reservation at Alternate Locations (RSA) services for the twelve-month period ending March 31, 2011. In addition, El Paso proposed to credit Park and Loan (PAL) service revenues, by normalizing PAL revenues to account for the trend of declining prices. El Paso proposed to reduce PAL revenues by 40 percent, arguing that the average twelve-month forward

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[272] Ex. EPG-376 at 4-6 (Busby rebuttal test.).

[273] Ex. EPG-376 at 10; Ex. EPG-379.

[274] Ex. EPG-376 at 15-17.

[275] Ex. EPG-367 at 18.

price differential dropped by over 40 percent, from the base period to the twelve-month period ending March 11, 2011.[276] El Paso stated that the appropriate level of credits for interruptible transportation is dependent on the outcome of El Paso's 2008 Rate case.[277]

194. El Paso proposed different methods to calculate discounting adjustments for long-term and short-term contracts.[278] For long-term contracts, El Paso used the iterative method, and calculated a "discount adjusted" level of billing determinants by multiplying its billing determinants for discounted service by the ratio of its recourse rate to the discount rate. El Paso then multiplied its billing determinants for the discounted contracts by this rate to calculate a "discount adjusted" level of billing determinants, and calculated a new recourse rate based on the revised billing determinants. The process is repeated until the rate does not change. El Paso states that new rates are derived and the process begins again, continuing until the volumes associated with the discounted contracts are adjusted downward to the point that the recourse rate converges with the discount rate.

195. For short-term contracts, El Paso used the revenue credit method. Under the revenue credit method, El Paso reduced the reservation component of its cost of service by the annual revenues it received from its short-term contracts for the twelve months ending March 31, 2011. El Paso defended the revenue credit method for short-term contracts, because firm sales levels fluctuated and rates varied during the previous three years.

Trial Staff's Position

196. Trial Staff proposed to increase El Paso's reservation billing determinants so that El Paso would bear some costs of throughput declines.[279] Staff proposed to average contract volumes for the twelve months ending March 31, 2011 with volumes from the 2006 Rate Case, i.e., the twelve months ending March 31, 2005, weighted on an 80/20 basis.

197. Trial Staff proposed to calculate usage billing determinants using volumes for the twelve months ending March 31, 2011. Trial Staff objected to El Paso's focus on three

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[276] El Paso Initial Br. at 66.

[277] *Id.* at 65.

[278] Ex. EPG-107 at 14-16; El Paso Initial Br. at 63 (citing *Williston IV*, 107 FERC ¶ 61,164).

[279] Trial Staff Brief on Exceptions at 91-95.

months of data as ignoring earlier test period data and not reflecting annual usage. Trial Staff argued that El Paso's proposal unfairly transfers the risk and costs of El Paso's declining throughput to its customers.[280] Trial Staff also recommends that the cost of service be credited with actual revenues received by El Paso for PAL, AOR, IHSW, and RSA services rendered between April 1, 2010 and March 31, 2011.

Initial Decision

198. The Presiding Judge adopted El Paso's position with respect to using the billing determinants as of March 31, 2011, with adjustments for normalization and discounting.[281] The Presiding Judge described El Paso's calculation of long-term firm maximum recourse rate reservation billing determinants as (a) calculating the average contract demands for the last twelve months of the test period ending March 31, 2011; (b) removing (normalizing) any contracts that expired; and (c) adding and annualizing any new contracts in effect on the last day of the test period.[282] The Presiding Judge found that the appropriate level of long-term firm maximum recourse rate reservation billing determinants was 2,348,836 Dth/d,[283] based on Commission precedent.[284] The Presiding Judge rejected as unsupported claims that the resulting figure was not representative of anticipated volumes and also rejected Trial Staff's proposal to weight

[280] Trial Staff Initial Br. at 100-02.

[281] ID, 139 FERC ¶ 63,020 at PP 128-129.

[282] The updating process reduced El Paso's billing determinants by approximately 5,000 Dth/d. ID, 139 FERC ¶ 63,020 at P 128 (citing Tr. 1927).

[283] *See* Ex. EPG-377 at 4 (Long-term Firm Non-Article 11.2(a) Maximum Rate Billing Determinants).

[284] Citing *Trunkline*, Opinion No. 441, 90 FERC at 61,084; *Williston Basin Interstate Pipeline Co.*, 87 FERC ¶ 61,264, at 62,012 (1999) (emphasis added) (*Williston V*):

> With regard to long-term contract demand, the Commission's general policy has been to use the contract demand *on the last day of the test period* or the date the rates go into effect in order to reflect the latest best evidence of what will exist for the pipeline once the rates go into effect.

Accord Kern River, Opinion No. 486-B, 123 FERC ¶ 61,056 at P 285.

volumes against 2006 Rate Case levels as inconsistent with El Paso's end of test period conditions.

199. The Presiding Judge also used end of test period volumes to calculate El Paso's discounted long-term firm reservation billing determinants of 980,644 Dth/d, with $70,776,679 in revenues,[285] and short-term firm reservation billing determinants of 755,458 Dth/d, with $19,880,773 in revenue.

200. The Presiding Judge rejected El Paso's proposal to further adjust usage billing determinants by averaging the actual monthly volumes in January through March 2011 and annualizing the result; he found that data for the twelve-month period ending March 31, 2011 should be used.[286] The Presiding Judge noted that El Paso failed to present evidence that El Paso's proposed three-month period was more representative of future expectations, and instead adopted 1,226,034,128 Dth for usage billing determinants based on the end of test period data.[287]

201. The Presiding Judge likewise found that the appropriate PAL revenue credit should be the amount for the twelve months ending March 31, 2011, or $18,954,862.[288] The Presiding Judge rejected El Paso's proposed 40 percent PAL revenue credit reduction, finding that El Paso failed to establish a trend requiring the PAL revenue credit to be normalized.[289] The Presiding Judge found that the interruptible transportation service credit was resolved by Opinion No. 517.[290]

202. The Presiding Judge found that El Paso and Trial Staff agree on a $3,409,327 cost of service credit for AOR, IHSW, and RSA, which was otherwise uncontested.[291]

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[285] ID, 139 FERC ¶ 63,020 at P 129 (citing Ex. EPG-380 at 4 (Long-Term Firm Discount Billing Determinants); Ex. EPG-376 at 12 (Busby Rebuttal test.)).

[286] *Id.* P 132.

[287] *Id.* P 132. *See* Ex. EPG-382 at 1 (Usage Billing Determinants).

[288] ID, 139 FERC ¶ 63,020 at P 134.

[289] *Id.*.

[290] Opinion No. 517, 139 FERC ¶ 61,095 at P 184 (affirming the Commission's general policy favoring a 100 percent load factor IT rate).

[291] ID, 139 FERC ¶ 63,020 at P 133.

Briefs on Exceptions

203. Trial Staff defends its proposal to increase billing determinants and revenue credits in order to ensure that El Paso shares a small portion of the costs resulting from throughput declines.[292] Trial Staff argues that the Presiding Judge's reliance on *Trunkline* was in error.[293]

204. El Paso disagrees with the Presiding Judge's rejection of its proposed normalization adjustment and argues it should be reversed and the PAL credit should be accepted. El Paso contends that to account for the trend in lower prices, and hence lower PAL revenues, it is appropriate to normalize revenues using the pricing trend demonstrated by forward prices reported for the twelve-month period ending March 31, 2011.[294]

Briefs Opposing Exceptions

205. El Paso contests Trial Staff's proposal to increase billing determinants so that El Paso shares the risk of unsubscribed capacity. El Paso argues that it would be unlawful to increase billing determinants above a level which provides El Paso with a reasonable opportunity to recover its costs.[295]

Commission Determination

206. For this rate case, El Paso's filed base period (actual volumes) ended June 30, 2010 and its test period ended March 31, 2011 (that is, the end of adjustment period reflecting annualized quantities, known and measurable with reasonable accuracy).[296] El Paso updated its filed position to reflect the actual quantities for the twelve months ending March 31, 2011.[297] No party objected to El Paso's use of updated figures.

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[292] Trial Staff Brief on Exceptions at 10, 90-92, 97-99.

[293] *Id.* at 93.

[294] El Paso Brief on Exceptions at 96-97.

[295] El Paso Brief Opposing Exceptions at 38.

[296] Ex. EPG-107 at 7 (Rezendes direct test.).

[297] *See* El Paso's May 16, 2011 45-day update filing, required by 18 C.F.R. § 154.311 (2013) (45-Day Update).

207. The Commission finds that it is appropriate to use El Paso's proposed reservation billing determinants as of March 31, 2011 – for both non-Article 11.2 and Article 11.2 contracts – as annualized and adjusted for discounting.[298] The Commission affirms the Presiding Judge's finding that it is appropriate to use contracts in effect during the test period while excluding any contracts that expired and were not renewed prior to the last day of the test period. Further, the Commission finds that it is appropriate to include and annualize any new contracts beginning during the test period and remaining in effect on the last day of the test period. Annualizing the volumes from contracts in effect as of the last day of the test period is consistent with Commission policy as set forth in *Trunkline*.[299] Therefore, the Commission affirms the Presiding Judge's approval of El Paso's methodology for determining the appropriate level of non-Article 11.2 reservation billing determinants.

208. The Commission affirms the Initial Decision with respect to the non-Article 11.2 usage billing determinants. Adjusting the volumes for unusual weather patterns may be appropriate if the pipeline proposed to rely on base period volumes. Indeed, the purpose of test period projections is to adjust the base period actuals for known and measurable changes, which could include adjustments for anomalies in weather during the base period.[300] However, El Paso chose to update its filed position with actual volumes for the twelve-month period ending on March 31, 2011. The Commission agrees with Trial Staff that El Paso is trying to extend the test period to project further declines in throughput. El Paso had the right to argue for normalizing volumes as part of its test period projections. However, El Paso gave up that right when it revised its filed case to use actual volumes for the twelve months ending March 31, 2011. Accordingly, the Commission affirms the Presiding Judge's finding that El Paso should use actual usage billing determinants for the twelve months ending March 31, 2011 to develop rates. The Presiding Judge found that El Paso failed to support its claim that the January-March 2011 usage data reflects a trend rather than some unexplained aberration, noting that El Paso failed to cite data falling outside the test period and that the presence of the cold snap and a corresponding spike in usage itself supported a finding that the time frame is an aberration. The Commission agrees with the Presiding Judge that El Paso failed to

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[298] Issues concerning Article 11.2 and whether El Paso may seek a further adjustment based on its failure to recover the maximum rate under the 1996 Settlement rates are addressed later in this order.

[299] *Trunkline*, Opinion No. 441, 90 FERC at 61,084. *See also Williston V*, 87 FERC at 62,012; *Kern River*, Opinion No. 486-A, 123 FERC ¶ 61,056 at P 285.

[300] 18 C.F.R. § 154.303(a)(4) (2013).

point to record evidence to support its inference that the January – March 2011 time frame reflects an ongoing trend in usage.[301]

209. The Commission rejects El Paso's proposal to credit revenues for Article 11.2 usage charges. As discussed *infra*, the Commission finds that El Paso's proposed bifurcated cost of service is not just and reasonable. Because El Paso's revenue crediting proposal for Article 11.2 usage charges is part of El Paso's bifurcated cost of service proposal, the Commission finds that it is not appropriate for El Paso to credit revenues for Article 11.2 services while using actual billing determinants for its non-Article 11.2 transportation services. Therefore, in its compliance filing, El Paso should reflect the actual billing determinants for the year ending March 31, 2011 for all its transportation services, including Article 11.2 services.

210. The Commission concurs with the Presiding Judge and finds that the use of actual revenues for the twelve months ending March 31, 2011 is appropriate for determining the level of the revenue credit for PAL, AOR, IHSW and RSA services. The Commission further affirms the Presiding Judge's finding that the Commission's determination requiring the use of a 100 percent load factor IT rate is appropriate here.[302]

211. The Commission affirms the Presiding Judge's acceptance of El Paso's proposal to calculate its discount adjustment by applying the iterative, ratio methodology to long-term contracts and to credit its cost of service by the revenues received for short-term volumes.

B. Cost Allocation and Rate Design

1. Zone-of-Delivery Methodology (Stipulated Issue VII.A)

El Paso's Proposal

212. To allocate its costs, El Paso uses a zone-of-delivery rate design methodology, in which rates are established for state-wide delivery zones: California, Nevada, Arizona, New Mexico, and Texas. Shippers pay the same rate to deliver gas to any point within the zone. El Paso reported that the resulting transportation rates generally increase in modest increments from east to west, in line with El Paso's historical approach. In this proceeding, El Paso proposed to create a single zone for the three westernmost states:

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[301] ID, 139 FERC ¶ 63,020 at P 132.

[302] Opinion No. 517, 139 FERC ¶ 61,095 at P 184 (affirming the Commission's general policy favoring a 100 percent load factor IT rate).

California, Arizona and Nevada. Also, El Paso proposed to change its cost allocation methodology for the production area zone.[303]

213. El Paso first classified its transmission costs as either fixed or variable and then as non-mileage-based or mileage-based.[304] El Paso further stated that all of its variable costs are treated as mileage-based and recovered through its delivery-zone usage charges.[305] The non-mileage-based costs *are not* distance sensitive and are allocated on an equal basis by Dth unit. The mileage-based costs *are* distance sensitive and are allocated on a Dth-mile basis. El Paso proposed to determine mileage on specific receipt and delivery points (or pools) and the paths specified by each firm shipper's contract. El Paso proposed to calculate contract path mileages using a model that consists of a series of tables showing a "node" for each physical location (meter, junction, compressor station) on the pipeline and "arcs" that connect these locations.[306] El Paso proposed to reflect the contract paths by breaking the arcs into segments and using a linear optimization program to calculate the shortest distance for the contract.[307] El Paso explained that once the mileage associated with each shipper's contract path is determined, it then calculates the total mileage for each delivery zone, weighted by all firm contract volumes. El Paso stated that it would determine a weighted average using all long-term and short-term firm contracts, including both recourse rate contracts and contracts with discounted rates.[308]

214. For "contra flows," that is, contract-path service over mainline segments in the opposite direction of the predominant flow, El Paso proposed to assign zero mileage-based costs, recognizing a modest sensitivity in miles of haul along the pipeline, while acknowledging fuel savings attributable to backhauls and displacements. For the production area (Within Basin) zone, El Paso proposed to treat all flows as having a positive mileage. For bi-directional lines, El Paso proposed to assign a positive mileage if the line had a consistent flow in a single direction for a significant period of time.

[303] *See* ID, 139 FERC ¶ 63,020 at P 190. The El Paso system includes a Within Basin or production area zone in addition to the five state-zones. This sixth zone applies to all transportation service within the San Juan, Anadarko, and Permian Basins.

[304] Ex. EPG-107 at 6-7.

[305] El Paso Initial Br. at 89.

[306] Ex. EPG-107 at 21-22.

[307] Ex. EPG-107 at 23.

[308] Ex. EPG-312 at 7.

However, if the bi-directional line did not have a consistent flow in a single direction, it would receive the same treatment as other contra-flow lines, i.e., positive miles in the Within Basin zone and zero miles in the other zones.[309]

Other Parties' Positions

215. At hearing, Texas Gas Service contended that El Paso's proposed Dth-mileage study is not just and reasonable because it is based on contract-path miles that are not necessarily representative of actual operations.[310] By comparing each contract path to the actual aggregate physical flows on El Paso's system for the test period, Texas Gas Service found that approximately 23 percent of El Paso's contract volumes were associated with "unsupportable" paths, due to the fact that these paths required the use of displacement.[311] Texas Gas Service therefore proposed a miles-of-haul methodology to more closely reflect the actual physical assets that are used to fulfill El Paso's firm contract obligation at peak times.[312]

216. Trial Staff contended that El Paso's zone-of-delivery rate structure is flawed to the extent that it relies on contract paths that do not reflect the way that gas actually flowed on El Paso's system during the base and test periods.[313] Trial Staff noted that approximately 20 percent of El Paso's contract paths involve "impossible" paths in which gas did not or could not flow along the contract path during the base and test periods. Therefore, for these impossible paths, Trial Staff adjusted El Paso's contract-path miles to reflect plausible miles of haul for the contract- path distances.[314]

217. Edison and SoCal Gas/San Diego contended that El Paso's proposed zone-of-delivery methodology fails to recognize that the distance that gas is transported on El Paso's system is not a material factor affecting the cost of transportation. Edison contended that methodology is unjust and unreasonable due to (a) the predominance of receipts in the San Juan Basin, (b) the integrated and reticulated nature of the system, (c) El Paso's significant use of displacement, and (d) other operational factors. Accordingly,

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[309] Ex. EPG-107 at 28; Ex. EPG-312 at 7.

[310] Texas Gas Service Initial Br. at 7-8.

[311] *Id.* at 11.

[312] *Id.* at 15.

[313] Trial Staff Initial Br. at 108.

[314] *Id.* at 114-115.

Edison proposed that the zone-of-delivery rate be replaced with postage-stamp rates for all mainline transportation service.[315]

218. APS argued that the contract-path method is an appropriate basis for allocating distance-based costs.[316] However, APS contended that short-term firm and intra-zone contracts should be excluded from the calculation because they are not representative of the cost of traditional long-haul transportation service. Rather, short-term firm contracts represent opportunistic revenues similar to the role that interruptible transportation used to play on El Paso's system. APS argued that intra-zone contracts in California utilize only 174 miles as compared to 782 miles for long-term contracts from traditional production areas to California delivery points. Thus, APS argued that El Paso's average zonal miles-of-haul should be modified to reflect the exclusion of the short-term firm transportation and intra-California-zone contracts.

219. ACC/Southwest Gas supported El Paso's contract-path methodology, but proposed that fixed costs be allocated across zones based on contract demands, unadjusted under the iterative method for discounting, to properly reflect the cost responsibility of each zone. In the alternative, ACC/Southwest Gas opposed including short-term and long-term discounted contracts in the fixed price cost allocation. ACC/Southwest Gas argued that these modifications were necessary to prevent recourse rate shippers from subsidizing the discounted rates for California shippers.[317]

Initial Decision

220. The Presiding Judge found that El Paso's proposed zone-of-delivery methodology, which was based on contract paths, is a just and reasonable methodology for allocating El Paso's mileage-related fixed costs, which equal approximately 75 percent of its total cost of service. He found that El Paso's pipeline system is an integrated and reticulated system. He also found that although it is possible to determine general flow patterns around the system, it is impossible to determine either the true source of gas or the actual physical path it followed to reach its delivery point. Further, he found that the zone-of-

[315] Edison Initial Br. at 5-6; SoCal Gas/San Diego Initial Br. at 20. Edison proposed a zone-matrix approach if its postage-stamp rate proposal were not adopted. Edison Initial Br. at 50. Since Edison did not raise this alternative approach in its brief on exceptions, the Commission will not address the proposal in this opinion.

[316] APS Initial Br. at 13-14.

[317] ACC/Southwest Gas Initial Br. at 9-10.

delivery method recognizes operational efficiencies created by the integrated complex of facilities.[318]

221. The Presiding Judge found that El Paso's contract-path methodology does not attempt (or need) to trace the specific course followed by any delivered gas to reach its contractual delivery point or determine the actual miles of haul involved in getting it there. He found that the contract-path methodology involves complex calculations which rely on the shortest average physical pipeline routes between the primary receipt and delivery points specified in the contracts.[319]

222. The Presiding Judge found that any attempt to design El Paso's rates or to allocate fixed costs based on actual system gas flows/miles of haul was untenable.[320] He characterized Texas Gas Service's and Trial Staff's proposed mileage-based methodologies as attempted proxies for actual physical flow and miles-of-haul determinations. The Presiding Judge indicated that neither alternative methodology calculated the actual distances gas travels over El Paso's system any better than El Paso's proposed contract-path methodology.[321] The Presiding Judge stated that the contract-path methodology has numerous advantages over methodologies based on actual miles of haul, finding that the contract-path (a) simultaneously sidesteps and transcends the problems associated with trying to determine actual miles of haul on an integrated/reticulated system, (b) equates to the rights of shippers to use capacity, and (c) would allocate costs in a manner that reflects the integrated nature of the system facilities required to provide service and reliability to each firm shipper.[322]

223. The Presiding Judge found that El Paso's state-defined rate zones had been previously approved by the Commission, establishing a presumption that they remain just and reasonable. However, the Presiding Judge found that this presumption did not apply to the contract-path methodology, the three-state rate zone (for California, Arizona and Nevada), or the Within Basin zone proposal. The Presiding Judge found that El Paso bears the burden to prove the justness and reasonableness of any changes it proposes to its previously approved zone-of-delivery rate design.[323] The Presiding Judge found that

[318] ID, 139 FERC ¶ 63,020 at P 160.

[319] *Id.* PP 158, 164.

[320] *Id.* PP 160, 165.

[321] *Id.* P 161.

[322] *Id.* P 165.

[323] *Id.* PP 153-157.

El Paso established – by a preponderance of evidence – that its proposal to allocate mileage-related costs on contract paths is just and reasonable. He therefore found that it is immaterial if there are better alternatives. Thus, upon approving El Paso's proposal, the Presiding Judge did not address the merits of the postage-stamp rate proposals.[324]

224. The Presiding Judge found that the contract-path methodology precludes the exclusion of any contracts for which there are firm contract rights, including short-term, intra-zone, or discounted contracts.[325] The Presiding Judge found short-term firm transportation service is not analogous to interruptible transportation service because firm service reflects firm capacity rights while interruptible service does not. He further found that because El Paso's contract-path methodology does not distinguish between undiscounted and discounted firm contracts, ACC/Southwest Gas failed to support their proposed adjustment to that methodology.[326]

225. The Presiding Judge found the contract-path proposal just and reasonable, citing the fact that it was impossible to trace gas flows on the system. In addition, the Presiding Judge rejected the three-state rate equalization zone and the Within Basin zone as inconsistent with the contract-path proposal. In addition, the Presiding Judge found that the three-state zone required inter-customer subsidies.

a. Is El Paso's Contract-Path Methodology Just and Reasonable for Allocating Mileage-Related Costs?

Briefs on Exceptions

226. SoCal Gas/San Diego argue that the distance-of-haul has not been shown to cause a material variation in the cost of providing transportation service. They argue that a mileage-based cost allocation methodology is not just and reasonable because it assumes that all Dth-miles are equal in causing costs. They argue that the record evidence shows that El Paso's unit cost for deliveries to California is materially lower than the unit cost for deliveries to Arizona, because the Arizona facilities include more meters and smaller diameter laterals, which could result in greater cost per unit of throughput in the Arizona zone.[327]

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[324] *See Id.* PP 154-157, 182.

[325] *Id.* P 167.

[326] *Id.* PP 168-174.

[327] SoCal Gas/San Diego Brief on Exceptions at 18-20.

227. SoCal Gas/San Diego also argue that the Presiding Judge is incorrect in stating that El Paso's contract-path methodology does not need to trace actual gas flows on the system or determine the actual miles of haul. They argue that the premise of the contract-path methodology is that the costs of providing transportation vary in proportion to the number of miles measured by the different contract paths to the different mainline zone rates. They further argue that the assumptions for the contract-path methodology are that the actual miles of haul can be accurately measured and that all Dth-miles are equal in causing costs. SoCal Gas/San Diego contend that El Paso's proposed contract-path methodology is unjust and unreasonable because it is a mileage-based cost allocation methodology on a system where any attempt to allocate the pipeline's fixed costs based on actual miles of haul is untenable.[328]

228. SoCal Gas/San Diego argue that contract delivery paths were developed in a settlement and were never approved for purposes of cost allocation. SoCal Gas/San Diego also argue that an assumption underlying the Presiding Judge's approval of El Paso's proposed contract-path methodology is that the right to segment capacity on a longer path is more valuable than the right to segment capacity on shorter paths. SoCal Gas/San Diego contend that this erroneous assumption may be due to the complexity of El Paso's calculations and the fact that contract paths only approximate actual flows when the system is fully contracted.[329]

229. Edison argues that the distance that gas is transported on El Paso's system is not a material factor in cost causation due to (a) the impossibility of determining actual flows, (b) the integrated and reticulated nature of the system, (c) the predominance of receipts in the San Juan Basin, (d) the significant use of displacement, and (e) the changing system flow patterns.[330] Edison also argues that case law supports postage-stamp rates if based on specific operational facts and circumstances.[331]

230. Edison also argues that the Presiding Judge erred because it failed to recognize that approximately 75 percent of the cost of service for El Paso's system does not materially vary with distance.[332] Edison further argues that the Presiding Judge erred

[328] *Id.* at 14-19.

[329] *Id.* at 7-8, 16-17.

[330] Edison Brief on Exceptions at 14, 41-51.

[331] *Id.* at 52-53 (citing *Northwest Pipeline Corp.*, 82 FERC ¶ 61,158, at 61,581 (1990) (*Northwest II*)).

[332] *Id.* at 7, 12, 14.

because it adopted El Paso's use of contract paths in constructing its zone-of-delivery rate design. Edison argues that the zone-of-delivery methodology masks price signals by unreasonably averaging together all contracts for transportation to the same delivery zone, regardless of the receipt point.[333]

231. Texas Gas Service and Trial Staff take exception to the Presiding Judge's ruling that El Paso's unadjusted contract-path methodology is just and reasonable.[334] In addition, they take exception to the Presiding Judge's ruling that any attempt to design El Paso's rates or to allocate fixed costs based on actual system gas flows or miles of hauls is untenable.[335] Texas Gas Service and Trial Staff argue that it is possible to reasonably establish the gas flow patterns on El Paso's system by analyzing the actual data over the course of the test period.[336] Moreover, Trial Staff argues that the mileages for impossible paths must be adjusted in order to reasonably reflect the distance that gas travels on El Paso's system.[337] Texas Gas Service contends that unless rates properly reflect actual flows on the system, there will be a mismatch between the service provided and the rates charged for that service.[338]

232. Texas Gas Service also takes exception to the Presiding Judge's finding that since it challenged the contract-path methodology on the grounds that contract paths fail to reflect the actual system flows and mileages associated with a number of El Paso's contract paths, it is incumbent on Texas Gas Service "to demonstrate as a threshold matter what the actual flows and mileages associated with the challenged contracts/volumes actually were."[339] Texas Gas Service states that this finding imposes an impossible standard and is inconsistent with Commission precedent, which does not

[333] *Id.* at 29-33.

[334] Texas Gas Service Brief on Exceptions at 11, 54-56; Trial Staff Brief on Exceptions at 111.

[335] Texas Gas Service Brief on Exceptions at 11, 62; Trial Staff Brief on Exceptions at 112, 120.

[336] Texas Gas Service Brief on Exceptions at 58; Trial Staff Brief on Exceptions at 112.

[337] Trial Staff Brief on Exceptions at 121.

[338] Texas Gas Service Brief on Exceptions at 57.

[339] *Id.* at 62-63.

require tracing of molecules in order to reflect a miles-of-haul in rates.[340] In addition, Texas Gas Service argues that the method used to allocate costs should be a practical one that does not require speculations and assumptions but rather one that uses ascertainable facts.[341]

233. Texas Gas Service and Trial Staff object to the Presiding Judge's finding that El Paso is a reticulated system.[342] They contend that although El Paso's system is operated in an integrated manner, it does not have a web-like structure nor is it confined to a single geographic area. In addition, they note that El Paso's receipt and delivery points are not interspersed throughout El Paso's system; rather, the receipt points are in the San Juan and Permian Basins and the delivery points are predominantly in southern Arizona and California. They further note that bi-directional flows are limited and that displacements do not play such a significant role on El Paso's system as to warrant postage-stamp rates.

234. APS argues that the Presiding Judge erred by including short-term firm contracts in the calculation of average miles of haul.[343] APS argues that short-term contracts bear no relationship, from a cost-causation standpoint, to the relative cost of long-term transmission service to each of El Paso's zones. APS also argues that the inclusion of short-term firm contracts in the calculation of El Paso's mileage-based allocation factor represents a departure from El Paso's historical practice and is not supported by reasoned explanation or by evidence of cost causation. APS contends that short-term firm services provide opportunist revenues similar to interruptible service. APS also contends that the execution of short-term firm contracts was driven by the turnback of long-term firm capacity. APS argues that it is unjust and unreasonable for California shippers to benefit, at the expense of Arizona shippers simply because the California zone experienced a capacity turnback situation which created the need to mitigate the resulting impact by selling capacity on a short-term basis under short-term firm contracts at deeply discounted prices and shorter hauls than the long-term firm contracts on the system.

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[340] *Id.* at 62 (citing *Natural Gas Pipeline Co. of Am.*, 92 FERC ¶ 61,221 at 61,740 (2000) ("it is not possible to trace the molecules of gas transported under any specific Natural rate schedule in order to determine their end-use after they enter Natural's and the LDCs' systems and are commingled") (*Natural Gas Pipeline*)).

[341] *Id.* at 62-63 (citing *Tenn. Gas Pipeline Co.* 27 FPC 202, 247 (1962)).

[342] *Id.* at 67-69 (citing to *Interstate Natural Gas Association of America v. FERC,* 285 F.3d 18, 42 (D.C. Cir. 2002) (*INGAA*)); Trial Staff Brief on Exceptions at 123-130.

[343] APS Brief on Exceptions at 8-12.

235. ACC/Southwest Gas argue that the Presiding Judge erred by rejecting both its proposals: (1) to allocate zonal costs initially based on all contract demands unadjusted for discounting and (2) in the alternative, excluding all discounted firm contracts from the Dth-mileage study. ACC/Southwest Gas argue that by socializing the revenue shortfall attributable to discounted contracts across all rate zones, El Paso fails to properly reflect the cost to serve the discounted contacts in each zone.[344]

Briefs Opposing Exceptions

236. ACC/Southwest Gas and Trial Staff disagree with Edison's and SoCal Gas/San Diego's arguments that costs do not vary materially with distance. They argue that El Paso's contract paths sometimes reflect actual gas flows, especially as the system approaches peak conditions. They also argue that contract paths represent shippers' rights on the system.[345] ACC/Southwest Gas argue that contract rights are a reasonable allocation method because of their relationship to service rights and economic value.[346] Trial Staff argues that distance is indeed a dominant cost factor on El Paso's system and that this distance factor has not been demonstrated to be offset by other factors.[347]

237. ACC/Southwest Gas argue that contract paths contained in service agreements do not necessarily reflect the shortest average route between receipt and delivery points and that the Presiding Judge's statements to the contrary constitute a finding that warrants reversal.[348] El Paso explains that its Dth-mileage study reflects the shortest distance for each individual path, but that it then averaged all of the different path mileages together to determine the average miles for each zone.[349]

238. ACC/Southwest Gas and Trial Staff argue that displacement is not significant enough on El Paso's system to offset distance as a cost factor or to justify the imposition

[344] ACC/Southwest Gas Brief on Exceptions at 23-33.

[345] ACC/Southwest Gas Brief Opposing Exceptions at 22, 27; Trial Staff Brief Opposing Exceptions at 146.

[346] ACC/Southwest Gas Brief Opposing Exceptions at 27.

[347] Trial Staff Brief Opposing Exceptions at 139.

[348] ACC/Southwest Gas Brief Opposing Exceptions at 14-15.

[349] El Paso Brief Opposing Exceptions at 48.

of postage-stamp rates.[350] ACC/Southwest Gas argue that while El Paso exploits displacement opportunities, it does not rely on displacement for contracting. ACC/Southwest Gas argue that some manner of reticulation and/or displacement may exist on a pipeline where transportation costs do vary by distance.[351]

239. ACC/Southwest Gas respond to Texas Gas System's argument that the methodology used to allocate costs should be a practical one. ACC/Southwest Gas contend that El Paso's use of cost-based contract paths is fair and straightforward, as well as consistent with economic efficiency and cost responsibility.[352]

240. ACC/Southwest Gas argue that El Paso's zone-of-delivery rates do not mask price signals. Moreover, ACC/Southwest Gas argue that contract paths do provide economic benefits because they represent tradable rights to capacity, and the party that places the highest value on the capacity can obtain it. In addition, ACC/Southwest Gas argue that one of the most important values that contract paths provide is the shipper's right to access particular supply basins. They contend that this value exists notwithstanding any commingling or displacement that occurs in the actual physical movement of gas. Further, because contract paths accord shippers with scheduling rights on defined and predictable paths, shippers can trade their capacity rights and release capacity in the secondary market. Thus, ACC/Southwest Gas contend that contract paths represent a reasonable allocation method because of their relationship to service rights and economic value. They further contend that because El Paso's contract paths define a shipper's transportation rights on the system, cost allocation based on contract paths is just and reasonable.[353]

241. APS disagrees with Texas Gas Service's and Trial Staff's exceptions, and supports the Presiding Judge's conclusion that El Paso's methodology reasonably reflects any material variation in the cost of providing service due to the distance over which transportation service is provided. APS contends that, if El Paso's system is operating at full capacity, the reservation of capacity as defined by a contract path ensures that the pipeline system can provide firm transportation service. Moreover, even if no other gas were flowing on El Paso's system, El Paso would be able to provide service at contract levels. Thus, APS argues that contract paths provide a meaningful measure of the

[350] ACC/Southwest Gas Brief Opposing Exceptions at 22-23, 59; Trial Staff Brief Opposing Exceptions at 158.

[351] ACC/Southwest Gas Brief Opposing Exceptions at 23-24.

[352] *Id.* at 20.

[353] ACC/Southwest Gas Brief Opposing Exceptions at 27-28.

relative cost of capacity associated with the shipments the pipeline stands ready to make.[354]

242. In response to Edison's argument that the zone-of-delivery method ignores the receipt point, El Paso concurs with the Presiding Judge that El Paso's mileage study charts the distances from each receipt point (or pool) to the specific delivery points in the zone. Thus, El Paso contends that contractual receipt points are not ignored.[355] Similarly, Trial Staff argues that only point-to-point rates do not incorporate any averaging for each receipt and delivery point combination and that point-to-point rates are not feasible because El Paso has over 500 receipt and delivery point combinations. Thus, Trial Staff argues that El Paso's averaging reasonably reflects the fact that El Paso uses facilities from various parts of the system to effectuate deliveries to a zone. Further, Trial Staff argues that averaging of all transactions within a zone is consistent with El Paso's contracting and scheduling practices, which often allow for multiple receipt points and within-zone delivery points.[356]

Commission Determination

243. The Commission affirms the Presiding Judge's finding that El Paso has made and supported its case that its proposed zone-of-delivery methodology is a just and reasonable methodology for allocating mileage-related costs. The Commission further affirms the Presiding Judge's finding that El Paso's proposed contract-path methodology for allocating mileage-related costs is just and reasonable. The Commission finds that it is appropriate to use contract paths because they represent specific routes along El Paso's pipeline system by which gas can be transported from the shipper's receipt point (or pool) to its delivery point.[357] Further, they represent paths which are not subject to prior claim by any other shipper.[358] In addition, the Commission finds that El Paso provided substantial evidence to support its proposal, providing a Dth-mileage study that is based on a thorough and detailed analysis of transportation paths for the base period using the receipt points (or pools) and delivery points specified in each firm shipper's contract.[359] The Commission finds that the Dth-mileage study supports El Paso's proposed rate

[354] APS Brief Opposing Exceptions at 6-7.

[355] El Paso Brief Opposing Exceptions at 60-61.

[356] Trial Staff Brief Opposing Exceptions at 151-152.

[357] Ex. EPG-224 at 9, 34, 45.

[358] *Id.* at 34. *See also* 18 C.F.R. § 284.8(a)(3) (2013).

[359] Ex. EPG-107 at 17-29.

design which reflects moderate, but reasonable, differences in rates due to distance sensitivity.[360] Moreover, the Commission finds that the Dth-mileage study is a practical method for tracking costs for El Paso's rates.

244. The Commission disagrees with Texas Gas Service's and Trial Staff's suggestion to use actual usage as opposed to contract paths to allocate fixed costs. In the Order No. 636 restructuring proceeding, the Commission established procedures for the restructured gas market, featuring a transition to a uniform pricing model, the SFV (straight-fixed variable) cost allocation and rate design methodology. In addition, the Commission established a capacity release program, to mitigate the effect of the transition to SFV.[361] Under the SFV methodology, rates are designed so that fixed costs are recovered through reservation charges. To implement these rate policies, El Paso's customers pay for a substantial portion of their rates in these capacity-based reservation charges, which then serve to facilitate the capacity release program. If the appropriate reservation billing determinants are used, the pipeline will recover its cost of service or revenue requirement. Thus, if capacity is released into the secondary market, the pipeline will still be able to recover its revenue requirement. However, shippers will have an incentive to release unused or underused capacity to offset their fixed costs. In order to release capacity, shippers need to know their capacity rights. For El Paso's shippers, these rights are specified in Appendix A to each shipper's transportation service agreement, as required by El Paso's FERC Gas Tariff. Thus, El Paso's long-standing contract-path methodology is consistent with the Commission's market restructuring policies.

245. As specified in its tariff, contract paths reflect the level of service El Paso is obligated to provide on any day (including peak days) and also reflect the pathed capacity (or portions thereof) that can be released by shippers.[362] As capacity release increases on El Paso's system, it is important that the cost allocation and rate design methodology account for the impact of the secondary market on El Paso's ability to recover its costs.

[360] Ex. EPG-107 at 30.

[361] *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation; and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, Order No. 636, FERC Stats. & Regs. ¶ 30,939, *order on reh'g*, Order No. 636-A, FERC Stats. & Regs. ¶ 30,950, at 30,597-98, *order on reh'g*, Order No. 636-B, 61 FERC ¶ 61,272 (1992), *reh'g denied*, 62 FERC ¶ 61,007 (1993), *aff'd in part and remanded in part sub nom. United Distribution Cos. v. FERC*, 88 F.3d 1105 (D.C. Cir. 1996), *order on remand*, Order No. 636-C, 78 FERC ¶ 61,186 (1997).

[362] *See, e.g.*, Ex. EPG-314 at 18.

246. While Texas Gas Service, SoCal Gas/San Diego and Edison cite purported inconsistencies in the Presiding Judge's description of the Dth-mileage analysis, the Commission finds distance does affect costs, and distance-based cost differentials were identified and considered by the Presiding Judge at hearing.[363] The Commission finds that the totality of the Presiding Judge's analysis of the Dth-mileage reflects reasoned-decision making, and the Commission affirms his determination on this issue.

247. There is no disagreement among the parties that El Paso operates an integrated system. When a pipeline operates an integrated system, all customers benefit from the facilities of the entire system.[364] This fact undercuts the shippers' arguments that the unit cost of delivering gas in one area is lower on a per-unit basis than in another area. There is no disagreement that displacement plays an important role in the operation of El Paso's system. This fact serves to underscore the difficulty of developing a flow-based methodology on the El Paso system, since the gas flows may not reflect the physical operations of the system to provide the requested services, although displacement is not relied upon for contracting purposes. Indeed, El Paso exploits displacement opportunities to maximize operationally available capacity and to reduce operating costs, such as those incurred for fuel and compression.[365]

248. While the Commission agrees with the Presiding Judge that El Paso's system has many characteristics of a reticulated system these characteristics do not offset the fact that distance remains a significant factor in determining the cost of transporting gas on El Paso's system, and the Commission finds the Presiding Judge took all these factors into account.

249. Parties take exception to the Presiding Judge's findings that actual flows cannot or need not be determined under El Paso's proposed use of contract path for allocating mileage-related costs. The Commission does not require that molecules be traced; the Commission has long recognized that the predominant flow of gas may not reflect the path of the contracted service.[366] Notwithstanding the impossibility of tracking every molecule, in this proceeding the evidence shows that when El Paso's system is operating near peak, the contract paths closely resemble actual flows.[367] Accordingly, the Initial

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[363] *See* ID, 139 FERC ¶ 63,020 at P 158 (citing Ex. EPG-107 at 21-22) and P 164 (citing Ex. EPG-107 at 21-22).

[364] Tr. 2166-27; Tr. 2296 (El Paso's Witness Westhoff testimony).

[365] Ex. EPG-145 at 4.

[366] *Natural Gas Pipeline,* 92 FERC at 61,740.

[367] Ex. EPG-224 at 9.

Decision's adoption of El Paso's contract-path methodology to allocate mileage-related costs is supported by the actual operation of El Paso's system during peak periods.

250. APS argues that short-term firm contracts bear no relationship to cost causation. Edison argues that changing system flow patterns and the predominance of receipts from the San Juan Basin indicate that distance is not a material factor in the causation of costs. The Commission disagrees with both APS and Edison. As noted above, El Paso operates an integrated system and receives gas from the San Juan, Anadarko and Permian Basins as well as from Rockies supplies.[368] El Paso's Dth-mileage study, which is based on billing determinants for the test period, recognizes contractual (reservation) and actual (usage) system flows on El Paso's system.[369] The Commission finds that El Paso's zone-of-delivery mileage study reasonably reflects the operational realities of El Paso's system.

251. Edison argues that El Paso's proposed zone-of-delivery methodology unreasonably averages together all contracts for transportation to the same delivery zone, regardless of the receipt point. The Commission finds that the averaging inherent in El Paso's existing zone-of-delivery rate design reasonably reflects the fact that El Paso uses facilities from various parts of the system to effectuate deliveries to a zone.[370] Indeed, averaging all of the transactions within a zone is consistent with El Paso's contracting and scheduling practices, which allow for multiple receipt points and within-zone delivery points.[371]

252. ACC/Southwest Gas argue that costs should by allocated across zones based on the contract demands of shippers in each zone unadjusted for discounting, arguing that cost allocation and rate design are separate steps in designing a pipeline's rates.[372] The Commission agrees and reverses the Presiding Judge's acceptance of El Paso's NGA section 4 proposal to use discount-adjusted billing determinants for cost allocation purposes. Instead, the Commission finds that El Paso should follow the Commission's policy to allocate costs among the zones using unadjusted billing determinants and should not thereafter reallocate costs using adjusted billing determinants to reflect discounted

[368] Ex. EPG-145 at 4-5.

[369] Ex. EPG-107 at 21.

[370] Ex. EPG-224 at 23-33.

[371] Ex. EPG-224 at 28.

[372] ACC/Southwest Gas Brief on Exceptions at 26-32 (citing *Williston IV*, 107 FERC ¶ 61,164 at PP 82, 91); *see* ID, 139 FERC ¶ 63,020 at PP 168-173.

volumes. In *Williston Basin*, the Commission made a thorough review of its precedent and determined that the cost of service should generally be allocated based on non-discounted volumes in order to properly match cost incurrence to cost causation.[373] *Williston Basin* specifically cited the example of long-line pipelines that have rate zones, where transmission costs are allocated or proportioned among the zones based on contract demand weighted for mileage:

> Generally speaking, the allocation of costs is a separate step in computing rates for services. For instance, on long-line pipelines that have rate zones, transmission costs are allocated or proportioned among the zones based on contract demand weighted for mileage. Contract demand is used because it provides a relative measure of the service levels that cause the company to incur the fixed costs associated with its system. In other words, a customer demanding twice as much service as another customer would be expected to pay twice as much for its service assuming the same distance haul. Once costs are allocated there is usually no need to revisit this step in the process of designing the pipeline's per unit rates because the allocation step apportions the cost responsibility to the classes of customer based on cost causation principles and the recovery of those costs is achieved through a subsequent rate design step.[374]

253. Thus, the policy is to allocate costs based on unadjusted billing determinants. The application of this policy is appropriate here. The costs El Paso incurs to serve the contract demands of its customers in each zone do not change depending upon whether the shipper pays the maximum rate or a discounted rate. The Commission rejected the use of discount-adjusted billing determinants for the allocation of costs as being unfair to customers except "where they are agreed to as part of a settlement, or in exceptional circumstances, such as . . . where the viability of the pipeline itself would be threatened."[375] Following this policy, El Paso should allocate its fixed costs to each zone based on unadjusted billing determinants. To allow El Paso to use discount-adjusted billing determinants for cost allocation purposes would understate the correct allocation of costs necessary to provide service within zones that have a disproportionate level of

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[373] *Williston IV*, 107 FERC ¶ 61,164 at P 91.

[374] *Id.* P 82.

[375] *Id.* P 93 (distinguishing *Southern Natural Gas Co.*, 65 FERC ¶ 61,348 (1994) as limited to its particular circumstances, or "sui generis").

discounts, such as the parties claim occurs in the California zone, and unreasonably overstate costs to shippers in other zones. Once costs are allocated there is no need to revisit this step in the process of designing the pipeline's per unit rates because the allocation step apportions the cost responsibility to the classes of customers based on cost causation principles, and the recovery of those costs is achieved through a subsequent rate design step. Once costs are allocated among zones and services, the Commission permits pipelines to adjust the recourse rates through a discount adjustment to recover these costs – such as we permit El Paso to do in this proceeding elsewhere in this order.

254. The Presiding Judge's findings were based on a discussion of our policies permitting discount adjustments to the billing determinants used to design per unit costs, after the pipeline's fixed costs have been allocated among rate zones. However, as *Williston Basin* demonstrates, those rate design considerations do not nullify the requirement that costs first be allocated among services and rate zones based on cost causation principles. As discussed in the next section, we will allow El Paso to use a full discount adjustment in designing its per unit rates.

255. Finally, Edison argues the Commission's decision in *Northwest* undercuts El Paso's distance-based rate proposal. Edison's argument is without merit. In the *Northwest* proceeding, Northwest proposed postage-stamp rates pursuant to NGA section 4. One party argued that mileage-sensitive rates were appropriate for Northwest's system. As stated in *Northwest*, and re-stated above, the party proposing to change the existing rates must show that they are unjust and unreasonable and that its proposed rates are just and reasonable.[376] For the reasons discussed *supra*, Edison has not made such a showing.

b. <u>Was a Postage-Stamp Rate Design Properly Rejected? (Stipulated Issue VII.C)</u>

<u>Briefs on Exceptions</u>

256. Edison and SoCal Gas/San Diego take exception to the Initial Decision's findings that El Paso had satisfied the burden of proof that its proposed zone-of-delivery rate design is just and reasonable. They further take exception to the findings that the proponents of postage-stamp rates had not met the dual burden of proving that the zone-of-delivery rate design is no longer just and reasonable, and that their proposed postage-stamp rate proposal is just and reasonable.[377]

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[376] *Northwest II*, 82 FERC ¶ 61,158.

[377] Edison Brief on Exceptions at 9, 15-16; SoCal Gas/San Diego Brief on Exceptions at 23.

257. SoCal Gas/San Diego argue that a postage-stamp rate design would reduce the impact of El Paso's discount adjustment because the rate in California, where discounts are required for the competitive market, would be reduced. They also argue that a postage-stamp rate would promote gas-on-gas competition between supply sources by not skewing the delivered cost of gas due to varying transportation costs.[378]

Briefs Opposing Exceptions

258. Indicated Shippers argue that Edison failed to prove that El Paso's existing zone-of-delivery rate design is unjust and unreasonable. Given that neither Edison nor SoCal Gas/San Diego proved that the existing methodologies were unjust and unreasonable, Indicated Shippers argue that the Commission need not address whether the postage-stamp rate design is a just and reasonable alternative.[379]

259. In response to Edison's contentions on competition, Texas Gas Service argues that postage-stamp rates will distort, not foster, gas-on-gas competition by forcing shippers in El Paso's eastern rate zones to subsidize transportation to El Paso's western rate zones.[380]

Commission Determination

260. The Commission affirms the Presiding Judge's finding that those proposing postage-stamp rates have not met the dual burden under NGA section 5 to prove that it is unjust and unreasonable for El Paso to continue to use rates based on state-defined zones and that postage-stamp rates are a just and reasonable alternative for the pipeline.[381] The courts have long recognized that there is no single just and reasonable rate, but instead that various rates may be just and reasonable.[382] The NGA gives the pipeline the primary initiative, through a section 4 filing, to propose its rates, terms, and conditions of

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[378] SoCal Gas/San Diego Brief on Exceptions at 23-24.

[379] Indicated Shippers Brief Opposing Exceptions at 17.

[380] Texas Gas Service Brief Opposing Exceptions at 69.

[381] ID, 139 FERC ¶ 63,020 at P 156.

[382] *Permian Basin Area Rate Cases*, 390 U.S. 747, 767 (1968). *Consolidated Edison Co. v. FERC*, 165 F.3d 992, 998, 1002-1004 (D.C. Cir. 1999) (*Consolidated Edison*), *aff'g*, *Tennessee Gas Pipeline Co.*, Opinion No. 406-A, 80 FERC ¶ 61,070, at 61,223-61,224 (1997). *See also Cities of Bethany v. FERC,* 727 F.2d 1131, 1138 (D.C. Cir. 1984) (*Cities of Bethany*); *Alabama Electric Cooperative, Inc. v. FERC*, 684 F.2d 20, 27 (D.C. Cir. 1982).

service.[383] If the pipeline's proposal is just and reasonable, the Commission must accept it, regardless of whether other just and reasonable rates, terms, and conditions of service may exist.[384] As discussed above, the Presiding Judge found, and the Commission affirms, that El Paso had satisfied its burden of showing that its proposed zone-of-delivery rate design based on contract paths is a just and reasonable methodology for allocating costs and designing rates for El Paso's transportation services. Thus, although a properly designed postage-stamp rate for El Paso's transportation services might also be just and reasonable, the Commission must accept El Paso's zone-of-delivery rate design if it is a just and reasonable methodology.[385]

2. <u>Equilibration of Rates for California, Nevada and Arizona (Stipulated Issue VII.B)</u>

261. El Paso proposes to "equilibrate" or establish the same rate for the California, Arizona, and Nevada rate zones, while maintaining separate zonal rates for New Mexico and Texas. El Paso states that the practical impact of this proposal is to slightly raise the rate in the Arizona zone and to slightly lower the rate in the California zone.[386]

<u>Initial Decision</u>

262. The Presiding Judge found that El Paso failed to prove that its rate equilibration proposal would be just and reasonable.[387] Moreover, the Presiding Judge found that El

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[383] *Mobile*, 350 U.S. 332, at 340-41 (1956) (holding that sections 4(d) and (e) and 5(a) of the NGA "are simply parts of a single statutory scheme under which all rates are established initially by the natural gas companies . . . and all rates are subject to being modified by the Commission upon a finding that they are unlawful"). *Public Service Commission of New York v. FERC*, 642 F.2d 1335, 1343-44 (D.C. Cir. 1980). *ANR Pipeline Co. v. FERC*, 771 F.2d 507, 513 (D.C. Cir. 1985) ("The policy of the NGA [is] to have rates set by pipelines, to be set aside and replaced by the Commission only when the privately-ordered rates are unreasonable."). *Consolidated Edison*, 165 F.3d at 1002 (stating NGA grants the "primary initiative for rate-setting to the pipeline").

[384] *Western Resources, Inc. v. FERC*, 9 F.3d 1568, 1578 (D.C. Cir. 1993) (*Western Resources*).

[385] Because we find El Paso's discounting proposal just and reasonable and consistent with our policies, we do not address SoCal Gas/San Diego's arguments that postage-stamp rates would produce a better result.

[386] El Paso Initial Br. at 76.

[387] ID, 139 FERC ¶ 63,020 at PP 178-181.

Paso's rate equilibration proposal would be at odds with nearly every argument El Paso made to support its contract-path methodology. Specifically, the Presiding Judge found that it was patently inconsistent for El Paso to defend the contract-path methodology by emphasizing its distance sensitivity, and then to immediately dampen the touted sensitivity by averaging it over three of the state-defined rate zones (out of five). In addition, the Presiding Judge found that El Paso's rate equilibration proposal would establish a rate design dichotomy on the system: one rate design for Texas and New Mexico, which would have distance-differentiated rates; and another rate design for California, Arizona and Nevada, which would have a postage-stamp rate.

263. The Presiding Judge found that El Paso's rate equilibration proposal would be discriminatory because it would reduce the California-zone rate by increasing the Arizona-zone rate. In addition, the Presiding Judge found that El Paso's claim that the higher per-unit cost for Arizona facilities offsets the higher distance-related costs to California was unsupported by any empirical cost comparison or analysis.[388]

264. In addition, the Presiding Judge found that El Paso's claims that chronic imbalances in the Arizona zone impose higher system costs vis-à-vis California are unpersuasive. He found that El Paso should have taken such differences into account when designing its contract-path methodology. Further, he found that El Paso's tariff contains service and penalty provisions which specifically address daily system imbalances when the system is operating under critical or strained operating conditions.

Briefs on Exceptions

265. El Paso argues that the Presiding Judge erred by rejecting its equilibration proposal and by failing to recognize that its equilibration proposal is needed to prevent subsidization of the Arizona zone by the California zone due to factors that are not reflected in its Dth-mile studies. In addition, El Paso argues that its proposal is reasonable and fully cost-supported.[389]

266. El Paso takes exception to the Presiding Judge's finding that there is no empirical evidence to support its equilibration proposal. El Paso argues that the record shows, with unrebutted expert testimony, that a large number of smaller diameter delivery laterals in Arizona have a higher per unit cost than the larger mainline facilities that serve

[388] *Id*. (citing Tr. 801, 1498 (El Paso's Witness Derryberry testimony)); Ex. SWG-87 at 2.

[389] El Paso Brief on Exceptions at 97-101.

California.[390] In addition, El Paso argues that the record shows that delivery laterals are not used in California, as gas is primarily delivered at the state border. El Paso argues that the record shows that in recent years it has spent approximately $41 million on its Pipeline Integrity Program to update the safety of the Arizona lateral system. Further, El Paso argues that the record shows that in contrast to California, which takes gas at a relatively constant rate, deliveries in Arizona are characterized by the prevalence of daily imbalances. Accordingly, El Paso argues that the higher system costs in Arizona offset the slightly higher distance to California, thus justifying western zone equilibration.[391]

267. El Paso argues that the Presiding Judge erred by failing to address Commission precedent that supports its proposal to reflect offsetting cost factors through equilibration. El Paso argues that in *Tennessee*, the Commission approved a rate design that accounted for the higher cost of smaller diameter delivery laterals in one particular zone, even though the pipeline's costs were rolled-in.[392] El Paso argues that *Tennessee* shows that while miles of haul are an important cost factor, they are not the only relevant factor.

268. In response to the Presiding Judge's finding that El Paso's tariff has provisions that address daily imbalances, El Paso argues that the possibility that a penalty might apply to excessive imbalances has nothing to do with whether daily imbalances within penalty tolerances impose facility or operating costs on the system and should be reflected as a factor offsetting distance in rate design.[393]

269. El Paso notes that the Presiding Judge implied that it is discriminatory and inconsistent for El Paso to propose equilibration of western zone rates but not for the eastern zones. El Paso argues that the Presiding Judge ignored the mileage difference between the two areas: about 700 miles for the western zone and 400 and 500 miles for Texas and New Mexico, respectively. El Paso argues that the difference in mileage justifies the different distance-sensitivity treatment.[394]

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[390] *Id.* at 102 (citing Ex. EPG-177 at 35-36; Ex. EPG-390 at 32:11-22; Ex. EPG-145 at 40; *see also* Ex. EPG-277 at 22:4-24:2; *see generally* Ex. EPG-145 at 36-40).

[391] *Id.* at 102-104.

[392] *Id.* at 104 (citing *Tennessee Gas Pipeline Co.*, Opinion No. 352, 27 FPC 202, 212-213 (1962) (*Tennessee*)).

[393] *Id.* at 104-105.

[394] *Id.* at 106.

270. Edison and SoCal Gas/San Diego argue that by rejecting the equilibration proposal, the Presiding Judge sought to devise an even more distance-sensitive rate than the one proposed by El Paso.[395] Edison argues that if the Commission does not adopt postage-stamp rates, it should at least approve El Paso's equilibration proposal.

Briefs Opposing Exceptions

271. ACC/Southwest Gas argue that El Paso's equilibration proposal is not justified on cost or competitive grounds. Rather, they argue that the proposal is a means to shift additional costs from the California zone to the Arizona zone.[396] ACC/Southwest Gas, APS, and Trial Staff take exception to El Paso's argument that no witness rebutted testimony that supported the higher unit cost in Arizona.[397] In fact, APS argues that the absence of a quantitative analysis is a fatal flaw in El Paso's case.[398]

272. Trial Staff argues that El Paso incorrectly claims that its offsetting cost theory is supported by precedent.[399] Trial Staff argues that in *Tennessee*, the Federal Power Commission (FPC) found that Tennessee's system costs should be allocated to all zones on its integrated system. Further, Trial Staff argues that the FPC permitted an adjustment for delivery laterals in the New England zone – the only zone that had such laterals. Trial Staff argues that three out of El Paso's five zones have delivery laterals.

273. In response to El Paso's argument that the variability of Arizona loads and higher imbalance costs in Arizona relative to California offset the higher distance to California, Trial Staff argues that customers who take gas on a non-ratable basis already pay higher rates under FT-H rate schedules. Further, Trial Staff argues that imbalance penalties compensate El Paso for daily imbalances during strained operating conditions.[400]

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[395] Edison Brief on Exceptions at 9, 55-58; SoCal Gas/San Diego Brief on Exceptions at 24-25.

[396] ACC/Southwest Gas Brief Opposing Exceptions at 31.

[397] ACC/Southwest Gas Brief Opposing Exceptions at 32-33, APS Brief Opposing Exceptions at 11, Trial Staff Brief Opposing Exceptions at 126.

[398] APS Brief Opposing Exceptions at 11.

[399] Trial Staff Brief Opposing Exceptions at 127-128 (citing *Tennessee*, 27 FPC 202, 212-213).

[400] *Id.* at 128.

Commission Determination

274. The Commission affirms the Presiding Judge's finding that El Paso failed to prove that its rate equilibration proposal would be just and reasonable. El Paso argues that its rate equilibration proposal is needed to prevent the subsidization of Arizona customers by California customers. El Paso argues that a number of factors weigh in favor of this proposal, including a high per-unit cost for smaller diameter delivery laterals and the cost of the Pipeline Integrity Program. The Commission finds that these factors are offset by other factors including the integrated manner in which El Paso operates its system, the mechanisms El Paso has to address costs associated with the non-ratable deliveries of gas, and significantly discounted rates for deliveries to California.

275. El Paso argues that the differences in mileages justify different distance-sensitivity treatment. The Commission finds that El Paso's zone-of-delivery cost allocation and rate design methodology reasonably reflects differences in mileages. As noted by the Presiding Judge, El Paso did not provide any empirical evidence to support its rate equilibration proposal.[401] El Paso proposed a detailed zone-of-delivery methodology based on a detailed Dth-mileage study to support its contract-path allocation; however, in order to apply its equilibration theory, El Paso proposes to make significant modifications to the results of that study without the same level of empirical support. This is not to say that a properly supported zone-of-delivery rate design with different types of zones for the eastern and western portions of the system could not be developed; but based on the evidence in this proceeding, El Paso did not show that its equilibration proposal would result in just and reasonable rates.

276. El Paso contends that the Presiding Judge's finding is inconsistent with the precedent established in *Tennessee*. The Commission disagrees with El Paso. Consistent with the FPC's finding in *Tennessee* and our findings *supra*, the Commission finds that El Paso's Dth-mile allocation is a reasonable allocation methodology. In *Tennessee*, the FPC found that it was impossible to identify the portion of the mainline facilities installed or used for the benefit of any individual customer.[402] The Commission finds in this proceeding that the same holds true for El Paso's mainline facilities. However, the Commission does not find that the treatment of delivery laterals in *Tennessee* supports El Paso's rate equilibration proposal. In *Tennessee*, the FPC stated:[403]

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[401] ID, 139 FERC ¶ 63,020 at P 181 (citing Tr. 1498: 17-22 (El Paso's Witness Derryberry testimony), Tr. 802:19-21 (El Paso's Witness Sullivan testimony)).

[402] *Id.* P 208.

[403] *Tennessee*, 27 FPC 202, 212-213.

> [T]he only characteristic of the New England zone which requires a departure from the Mcf-mile method, as a matter of allocation principle applied to the facts of record, is the city-gate service. . . . [A] basic difference between the New England zone and the rest of the Tennessee system lies in the fact that, in the New England zone only, Tennessee renders a city-gate service by means of numerous small-diameter laterals extending from the main-line to the city-gates of the communities served. The diameter of much of the pipe in the New England zone ranges from twelve inches down to three inches, whereas the smallest diameter of pipe anywhere else on the system in sixteen inches. The facilities required for this special type of service are readily distinguishable from general system facilities, and the costs thereof should be assigned to the New England zone.

277. In this proceeding, El Paso is arguing that the fact that it has delivery laterals in Arizona supports its equilibration proposal, which is intended to shift costs from California to Arizona. In *Tennessee*, the only delivery laterals were located in the New England zone, the most downstream zone of a long-line pipeline system, which extends from the supply area in Texas to New England.[404] El Paso's system is in the shape of an elongated oval, which connects to three major supply areas[405] and, unlike in *Tennessee*, has laterals all along the southern portion of its system, throughout Arizona, New Mexico and Texas.[406] El Paso's reliance on *Tennessee* to support it equilibration proposal is misplaced.

278. El Paso ultimately argues that if the Commission does not accept the western zone equilibration as a necessary element of its allocation and rate design method, then El Paso considers that the resulting zone-of-delivery rates would overstate the importance of distance in allocating costs.[407] El Paso did not, however, support this position in the affirmative, as required by the Commission's regulations.[408] Also, the list of stipulated

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[404] *Id., Tennessee,* 27 FPC 202, 222 and Appendix A (map of Tennessee's system).

[405] *See, e.g.*, ID, 139 FERC ¶ 63,020 at 8.

[406] Ex. EPG-157.

[407] El Paso Brief Opposing Exceptions at 47.

[408] 18 C.F.R. § 154.312(v) (2013); *Filing Requirements for Interstate Natural Gas Companies,* Order No. 582, FERC Stats. & Regs. ¶ 31,025, at 31,382 (1995), *order on reh'g*, FERC Stats. & Regs. ¶ 31,034, at 31,577 (1996)).

issues[409] identified the zone-of-delivery issue and the equilibration issue as separate issues. If it were essential to El Paso that they be treated as one integral issue, El Paso should not have agreed to list the issues as separate reserved matters. El Paso has made its case with respect to the zone-of-delivery methodology, but not with respect to the equilibration proposal. Accordingly, the Commission here affirms the Presiding Judge's findings, based on the evidence, to adopt the zone-of-delivery method, but to reject the equilibration proposal as insufficiently supported.

3. Rate Design for Rate Schedule FT-H Rates (Stipulated Issue VII.I)

279. El Paso provides four premium firm transportation hourly services, which allow a shipper to exceed its uniform or ratable hourly entitlement by a specified percentage for a specified number of hours each gas day. FTH-3 service entitles a shipper to 150 percent peak hour deliveries for 3 consecutive hours and 5 hours total. FTH-12 service entitles a shipper to 150 percent peak hour deliveries for 12 hours total. FTH-16 service entitles a shipper to 150 percent peak hour deliveries for 16 hours total. FTH-8 service entitles a shipper to 300 percent peak hour deliveries for 8 hours total.

El Paso's Proposal

280. El Paso stated that in order to provide hourly services, it must reserve capacity above and beyond what is needed for its ratable hourly deliveries.[410] El Paso proposed to allocate administrative and general (A&G) costs associated with that additional capacity to the hourly services. Based on two years of actual experience, El Paso determined that, when compared to ratable services, the FTH services require more complex (a) operational and gas control monitoring, (b) computer programming and maintenance, (c) management of gas flows and pipeline pressures, (d) hourly balancing, and (e) nominating and scheduling procedures.[411]

281. To assign these A&G costs to the FTH services, El Paso proposed a weighted premium factor. El Paso stated that it would use the weighted premium factor because it is consistent with the *Equitable* methodology.[412] In recognition of both the magnitude and duration of the various hourly services, El Paso develops a deliverability factor and a

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[409] *See* October 18, 2011 Joint Stipulation.

[410] Ex. EPG-107 at 30-31.

[411] Ex. EPG-107 at 20; EPG-394 at 36.

[412] *Equitable Gas Co*, 36 FERC ¶ 61,147 (1986) (*Equitable*).

capacity factor.[413] Initially, both factors would be weighed equally. Then, using the number of hours each of the hourly services are available and the hourly variability for each service, El Paso develops a premium factor which is only applied to the deliverability factor.[414] The weighted deliverability factors are 120 percent, 133 percent, 150 percent, and 300 percent for Rate Schedules FTH-3, FTH-12, FTH-16, and FTH-8, respectively. The capacity premium factor is 100 percent for each of the services. The premium factors are averaged for each rate schedule to develop the weighted premium factor. By using a premium factor, El Paso's proposal would allocate costs to the FTH services and away from other services.[415]

Other Participants' Positions

282. APS, Edison, Hourly Service Shipper Group, and SoCal Gas/San Diego argued that weighted premium factors should be based on capacity reservation nominations (CRN).[416] CRNs are based on a combination of empirical and physical data.[417] Trial Staff and UNS/Tucson Electric argued that El Paso's proposed allocation of non-mileage costs to the FTH services is unsupported and should be rejected.[418] In addition, Trial Staff argued that the premium should be applied to the capacity factor.[419]

283. Trial Staff, Hourly Service Shipper Group, and UNS/Tucson Electric argued that the weighted premium factors should not be applied to the full distance reflected in the zonal miles of haul, but rather, to only 300 miles.[420]

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[413] El Paso Initial Br. at 95.

[414] Ex. EPG-107 at 31-32; Ex. EPG-399.

[415] *See* Ex. EPG-59.

[416] APS Initial Br. at 39-40; Edison Initial Br. at 64-65; Hourly Service Shipper Group Initial Br. at 15-16, 20; SoCal Gas/San Diego Initial Br. at 64-65.

[417] Ex. EPG-107 at 34-35; Ex. EPG-145 at 50-51.

[418] UNS/Tucson Electric Initial Br. at 29-31; Trial Staff Initial Br. at 138-139.

[419] Trial Staff Initial Br. at 134.

[420] Trial Staff Initial Br. at 135-136; Hourly Service Shipper Group Initial Br. at 34-36; UNS/Tucson Electric Initial Br. at 26-29.

284. Trial Staff and Hourly Service Shipper Group argued that the 50/50 split between the deliverability factor and the capacity factor does not accurately reflect the actual amount of deliverability plant and capacity that is required to support hourly services. Based on Trial Staff's analysis, the split between deliverability and capacity should be 32/68.[421] Hourly Service Shipper Group argued that the cost of compression should be used to measure the incremental costs of providing hourly delivery flexibility.[422]

Initial Decision

285. The Presiding Judge accepted El Paso's proposal, except for assigning costs to the non-mileage deliverability component.[423] The Presiding Judge determined that it is just and reasonable for El Paso to use peak hourly entitlements to develop premium factors, as it is consistent with the overall contract-path methodology, in that it focuses on test period shipper contract-specified reservation quantities, and it is based on capacity rights.

286. The Presiding Judge also found that it is just and reasonable for El Paso to use a 50/50 split methodology to allocate firm hourly transportation services costs, as well as for El Paso to apply the weighted premium factors to the full distance reflected by the average zonal miles of haul.[424] The Presiding Judge found that since operational pack requirements vary by hourly service, it is inappropriate to substitute any inter-FTH service average mileage for service-specific mileages in the cost allocation methodology.

287. In addition, the Presiding Judge found that it is appropriate for the additional costs associated with FTH services to be reflected in the weighted premium factors. However, the Presiding Judge found that El Paso had not adequately supported its proposal to apply the weighted premium factors to non-mileage related costs and therefore did not satisfy its burden of proof.[425]

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[421] Trial Staff Initial Br. at 136-137; Hourly Service Shipper Group Initial Br. at 37-40.

[422] Hourly Service Shipper Group Initial Br. at 30, 32.

[423] ID, 139 FERC ¶ 63,020 at P 241.

[424] *Id.* PP 243-245.

[425] *Id.* P 246.

a. Is El Paso's Weighted Premium-Factor Methodology Appropriate?

Briefs on Exceptions

288. On exceptions, some parties contend that the Presiding Judge erred in ruling that the weighted premium-factor methodology was more appropriate than using the CRN methodology. APS argues that the Commission should reverse the Presiding Judge and direct El Paso to utilize CRNs as the appropriate basis for deriving the weighted premium allocation factors because they are consistent with cost causation.[426] Hourly Service Shipper Group argues that the Presiding Judge's acceptance of El Paso's proposed premium factors disregards the *prima facie* case it made in support of using CRNs.[427]

Briefs Opposing Exceptions

289. In response to arguments that CRNs should be used, El Paso argues that it must be prepared to provide all hourly services under all conditions. Accordingly, El Paso argues that the capacity-based principle should be reflected in rates.[428]

Commission Determination

290. The Commission affirms the Presiding Judge on the use of weighted premium factors for allocating costs to hourly services. The Commission finds that El Paso identified specific costs that it can attribute to hourly services based on observations and analyses by its expert witnesses.[429] The Commission recognizes that these are not new costs, but rather, costs associated with services that were previously allocated to all of El Paso's services. By identifying these costs and then allocating these costs away from other services, El Paso reduces the costs associated with providing its other services.[430] The Commission finds that El Paso's proposed methodology is just and reasonable.

291. As discussed above, the Presiding Judge found, and the Commission affirms, that El Paso satisfied its burden of showing that its proposed weighted premium-factor

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[426] APS Brief on Exceptions at 16-19. *See also* Hourly Service Shipper Group Brief on Exceptions at 21-25.

[427] Hourly Service Shipper Group Brief on Exceptions at 20, 36-38.

[428] El Paso Brief Opposing Exceptions at 77.

[429] Ex. EPG-107 at 18-20; Ex. EPG-394 at 36-37.

[430] Ex. EPG-59.

methodology is a just and reasonable methodology for allocating costs and designing rates for El Paso's FTH services.

292. The Commission recognizes that the hourly services proposed by El Paso in this case are designed, in part, to support gas-electric coordination. The Commission has expressed the expectation that "individual pipelines supporting gas fired generators will be considering the addition of other intraday nomination opportunities that would be of benefit to their shippers."[431] Providing flexible hourly services furthers this stated policy objective.

b. Is the Use of the *Equitable* Methodology Appropriate?

Briefs on Exceptions

293. Some parties and Trial Staff argue that the Presiding Judge mistakenly interpreted *Equitable* in calculating the incremental costs of premium services.[432] Trial Staff asserts that the hourly rates for premium services should be calculated based on an allocation of capacity and deliverability costs consistent with actual system utilization.[433] Hourly Service Shipper Group argues that the 50/50 split method that El Paso uses to weight its premium factors does not recognize the incremental cost of providing Hourly Services.[434] The group further argues that the Presiding Judge's failure to require a proper cost allocation methodology shifts $22 million in cost responsibility from FT-1 customers to Hourly Services customers.[435] SoCal Gas/San Diego argue that El Paso's application of the methodology to allocate costs to FTH services results in an under-allocation of costs to the FTH services; they argue that weighted premium factors should be applied to both the deliverability and capacity components.[436]

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[431] *Standards for Business Practices for Interstate Natural Gas Pipelines; Standards for Business Practices for Public Utilities*, Order No. 698, FERC Stats. & Regs. ¶ 31,251, at P 69 (2007).

[432] *Equitable*, 36 FERC ¶ 61,147. The Presiding Judge described the *Equitable* methodology as allocating fixed costs 50/50 between the deliverability and capacity components. ID, 139 FERC ¶ 63,020 at PP 243-244.

[433] Trial Staff Brief on Exceptions at 138-143.

[434] Hourly Service Shipper Group Brief on Exceptions at 17, 26.

[435] *Id.* at 19.

[436] SoCal Gas/San Diego Brief on Exceptions at 62.

Briefs Opposing Exceptions

294. In response to arguments that it misapplied the methodology in calculating costs of hourly services, El Paso argues that its proposed rate design is consistent with Commission precedent and represents a middle ground among the competing proposals.[437] Trial Staff contends that El Paso erroneously argues that it is undisputed that additional labor and computer assets are required to provide hourly services, and states that El Paso was unable to provide a calculation of the actual cost of administering hourly services.[438]

295. In response to arguments that premium costs for hourly services should be allocated to the capacity function, APS argues that capacity is not affected by the hourly services. Rather, APS argues that El Paso uses line pack and compression facilities to provide the flexible delivery entitlements. APS argues that these elements are properly viewed as delivery related.[439]

296. In response to arguments that the *Equitable* methodology was not properly applied, Hourly Service Shipper Group argues that the 50/50 split first prescribed in the *Equitable* method was for storage services and does not represent an allocation of costs to various transportation services to reflect the benefits to customers receiving those services.[440]

Commission Determination

297. In *Equitable*, the Commission determined that it was appropriate to recognize that storage facilities provide two separate services – capacity and delivery.[441] By providing for a 50/50 split of storage function fixed costs between a rate component based on capacity determinants and a rate component based on deliverability determinants, the Commission recognized that these services are equally important. As parties note, El Paso's hourly services are different than storage service although both involve capacity

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[437] El Paso Brief Opposing Exceptions at 71-76.

[438] Trial Staff Brief Opposing Exceptions at 168-69, 170.

[439] APS Brief Opposing Exceptions at 25.

[440] Hourly Service Shipper Group Brief Opposing Exceptions at 10-11.

[441] *Equitable,* 36 FERC at 61,367. The *Equitable* methodology is explained in detail at *Consolidated Gas Transmission Corp.*, 47 FERC ¶ 61,171, at 61,565, *reh'g denied*, 49 FERC ¶ 61,041 (1989).

and deliverability functions. El Paso explained how it applied and adapted the *Equitable* concept of recognizing that assets can provide different services, and applied that concept to its transmission assets for the purpose of allocating costs to its hourly services. El Paso's methodology included applying a weighted premium factor solely to the deliverability component because FTH services affect the hourly rate of gas flows. The Commission finds that El Paso's rationale for applying the weighted premium cost allocation factor solely to the deliverability component is reasonable. Accordingly, the Commission finds that the methodology that El Paso proposed for allocating costs for its hourly services is appropriate and results in just and reasonable rates.

c. Should Weighted Premium Factors be Allocated to the Full Miles of Haul?

Briefs on Exceptions

298. Parties argue that the Presiding Judge erred in not adjusting the cost allocation for FTH rates to reflect that the impact of hourly services attenuates after 300 miles. Trial Staff, UNS/Tucson Electric and APS argue that El Paso improperly applies premium factors to the total miles of haul used to allocate El Paso's fixed costs for hourly services to each zone, despite substantial evidence by El Paso's own operations expert that the impact of the service is restricted to an average of 300 miles.[442] Trial Staff argues that the full miles of haul should not be reflected in the premium attached to this use of the system by non-ratable services. Hourly Service Shipper Group further notes that hourly delivery flexibility does not affect the full contract path.[443]

Briefs Opposing Exceptions

299. In response to arguments that the premium factors should only be allocated to 300 miles, El Paso argues that the 300-mile limitation is an average and that the actual miles range from 160 miles for FTH-3 service to 530 miles for FTH-16 service. Thus, El Paso argues that applying an average 300-mile limitation would result in rates that are too high for FTH-3 and too low for FTH-16.[444]

[442] Trial Staff Brief on Exceptions at 145-48; UNS/Tucson Electric Brief on Exceptions at 7-11; APS Brief on Exceptions at 16-22.

[443] Hourly Service Shipper Group Brief on Exceptions at 17, 38-43.

[444] El Paso Brief Opposing Exceptions at 80. *See* also SoCal Gas/San Diego Brief Opposing Exceptions at 30-35.

Commission Determination

300. The Commission affirms the Initial Decision and finds that it is just and reasonable for El Paso to apply the weighted premium factors to the full distance reflected by the average zonal miles of haul. The Commission agrees with the Presiding Judge that it is inappropriate to substitute any inter-FTH service average mileage for service-specific mileages in the cost allocation methodology since use of the full distance is consistent with the contract-path methodology. Moreover, the Commission finds that limiting weighted premium factors to an average of 300 miles will result in the subsidization of the FTH-16 service by the FTH-3 service.[445] Further, the Commission disagrees with parties advocating that the more appropriate course of action is to use actual system utilization since the Commission is upholding the contract-path methodology.

d. **Should Premium Factors Be Allocated to Usage and Non-Mileage Related Costs?**

Briefs on Exceptions

301. Hourly Service Shipper Group argues that the Initial Decision accepts El Paso's proposal to assess weighted premium factors on variable costs allocated to hourly services without any supporting record evidence or rational basis.[446] It further argues that El Paso should not be permitted to apply premium factors to either usage mileage costs or usage non-mileage costs.[447]

302. El Paso takes exception to the Presiding Judge's ruling rejecting the application of the weighted premium factor to El Paso's hourly services non-mileage costs for lack of support.[448] El Paso argues that it is not possible to track these costs. Moreover, El Paso argues that the lack of quantification does not mean that the costs are not incurred.[449]

303. Parties state that the Presiding Judge erred in approving the use of premium factors to allocate non-mileage related costs. SoCal Gas/San Diego claim that failing to

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[445] Ex. EPG-394 at 34-35.

[446] Hourly Service Shipper Group Brief on Exceptions at 18, 43-46.

[447] Hourly Service Shipper Group Brief on Exceptions at 45.

[448] El Paso Brief on Exceptions at 16, 116.

[449] *Id.* at 117.

use premium factors in allocating non-mileage costs would cause FTH customers to receive the benefits of the non-mileage costs of capacity reserved to serve them, but without bearing the full cost of that capacity, and would therefore produce an inappropriate cross-subsidy in El Paso's rate structure.[450]

Briefs Opposing Exceptions

304. Hourly Service Shipper Group argues that even if El Paso did demonstrate that non-mileage costs vary with non-ratable deliveries, El Paso failed to demonstrate that the increase in cost is due solely (or even primarily) to FTH shippers. The Hourly Service Shipper Group argues that El Paso has failed to differentiate between the non-mileage costs that could be attributable to Hourly Services and those incurred to provide all the other transportation services on the El Paso system.[451]

Commission Determination

305. The Commission affirms the Presiding Judge's determination and finds that El Paso's use of weighted premium factors to allocate usage-related costs is appropriate. As noted above, El Paso has identified the types of costs it incurs to provide hourly services. Using its proposed weighted premium factor, it allocates costs away from other services and to the FTH services. The Commission finds that El Paso's proposed methodology is just and reasonable.

306. The Commission finds that the Presiding Judge erred in rejecting for lack of support the application of the weighted premium factor to El Paso's hourly services non-mileage costs. Several parties argue that because El Paso did not provide evidence of the level of costs associated specifically with usage or non-mileage functions for hourly services, usage and non-mileage costs cannot be included in the FTH rates. The Commission disagrees. The Commission approved an overall methodology for the FTH rates which is based on El Paso's proposed weighted premium factors. As the Commission did not require specificity in approving the overall methodology, it will not require specificity for parts of the methodology. To do so would require a quantification of costs that does not exist.[452] For new incremental capacity, it is easy to identify costs and quantities and develop new incremental rates. However, for the relatively new FTH services, there are no new facilities; rather, existing facilities and services have been re-allocated to provide the hourly services. In cases like this, "[a]llocation of costs is not a

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[450] SoCal Gas/San Diego Brief on Exceptions at 62-64.

[451] Hourly Service Shipper Group Brief Opposing Exceptions at 5-7.

[452] *See* Tr. 3357:3-7 (Lesser). *See also* El Paso Brief on Exceptions at 116-20.

matter for the slide rule. It involves judgment on a myriad of facts. It has no claim to an exact science."[453]

4. Rate Design for Rate Schedule IHSW Rates (Stipulated Issue VII.G)

307. El Paso's Rate Schedule IHSW (Interruptible Hourly Swing Service) permits a shipper to flow up to 160 percent of 1/24th of its daily scheduled quantity on an interruptible basis for up to 15 hours in any gas day without incurring hourly scheduling penalties.[454] Thus, IHSW service is an interruptible hourly service that permits a shipper to exceed the ratable level of its daily scheduled quantity.[455] The 2008 Rate Case Settlement included "black box" settlement rates, which included limited discounts under Rate Schedule IHSW.[456] In this proceeding, El Paso proposed to derive the rate for IHSW service from its proposed rate for firm service under Rate Schedule FTH-16 at the 100 percent load factor. El Paso stated that this proposal is just and reasonable because the IHSW service is simply an interruptible version of the FTH-16 service.[457]

Other Parties' Positions

308. Sempra stated that El Paso failed to carry its NGA section 4 burden of proof and therefore its proposed Rate Schedule IHSW rate design must be rejected.[458] Sempra stated that El Paso's proposed rates would subject El Paso's shippers to a "double charge" for the cost of ratable hourly service. In addition, Sempra argued that the rate should be based on the incremental cost of providing a non-ratable take in any hours in which the ratable entitlement is exceeded, and proposes that the IHSW rate should be derived based on the difference between the FTH-12 and FT-1 rates.[459] SoCal Gas and

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[453] *Colorado Interstate Gas Co. v. FPC*, 324 U.S. 581, 591 (1945).

[454] *El Paso Natural Gas Co.,* 114 FERC ¶ 61,305 (2006) (*March 23, 2006 Order*) (approving Rate Schedule IHSW service).

[455] IHSW service must be taken as a supplement to some underlying firm or interruptible service.

[456] *2008 Rate Case Settlement Order,* 131 FERC ¶ 61,077.

[457] Ex. EPG-394 at 46.

[458] Sempra Initial Br. at 15.

[459] *Id.* at 8, 11.

San Diego supported El Paso's derivation of the IHSW rate because it most closely approximates the hourly flexibility reflected in IHSW service.

Initial Decision

309. The Presiding Judge found El Paso's proposal to derive the IHSW rate from the FTH-16 rate to be just and reasonable, stating that Commission policy expressly permits one-part interruptible transportation services/rates to be derived from a comparable firm service. The Presiding Judge further found that the record indicates the most comparable firm service is the FTH-16 service.[460]

310. The Presiding Judge found that Sempra's double-charge allegation had inadequate record support. The Presiding Judge found that IHSW service is a separate and supplemental tariff service and that charging separate rates reflecting the costs of separate tariff services produced no double recovery. Finally, the Presiding Judge found that Sempra failed to demonstrate the full marginal cost of providing supplemental IHSW service would be captured through any incremental rate differential, including the FTH-12/FT-1 differential.

Briefs on Exceptions

311. APS and Sempra argue that the Presiding Judge erred by concluding that El Paso's proposed IHSW rate is consistent with Commission policy as reflected in *Elizabethtown* and *Arkla*. APS and Sempra state that in *Elizabethtown* and *Arkla*, shippers pay one-part rates for the full, interruptible equivalent of comparable firm service, while El Paso shippers must first subscribe to and pay rates for FT-1 or IT-1 service in order to purchase IHSW service. APS and Sempra argue that by tying the services together, shippers are forced to pay rates that far exceed the 100 percent load factor equivalent of the FTH-16 service. APS and Sempra argue that the cost of the tied services constitutes an unjust and unreasonable over-recovery of costs.[461]

312. Sempra further argues that the Presiding Judge erred by placing the burden of proof on Sempra to prove the rates were unjust and unreasonable, rather than requiring El Paso to carry its section 4 burden of proof.[462] Sempra also argues that the Presiding

[460] ID, 139 FERC ¶ 63,020 at P 201.

[461] APS Brief on Exceptions at 14-16; Sempra Brief on Exceptions at 16-17 (citing ID at P 201; *Elizabethtown Gas Co. v. FERC*, 10 F.3d 866, 871 (D.C. Cir. 1993) (*Elizabethtown Gas*); *Arkla Energy Resources, Co.*, 67 FERC ¶ 61,208 (1994) (*Arkla*)).

[462] Sempra Brief on Exceptions at 3, 13-16.

Judge erred in allowing a double-charge rate design that is excessive. In addition, Sempra argues that the appropriate rate for IHSW service should be less than the rate for non-ratable service; it should be no more than the incremental cost of providing non-ratable service.[463]

Briefs Opposing Exceptions

313. SoCal Gas/San Diego state that the Presiding Judge correctly found that El Paso's proposal for the IHSW rate to be a derivative of a 100 percent load factor comparable firm service (in this case, FTH-16) rate is just and reasonable, consistent with Commission policy, and based on an accepted rate design practice. SoCal Gas/San Diego state that IHSW service offers shippers an opportunity to minimize penalty exposure, as a supplement to other measures: adequate contracting, proper scheduling and possibly investment in assets to alleviate non-ratability of takes.[464]

314. El Paso notes that the Commission has previously rejected arguments that hourly flexibility should be offered on an incremental basis.[465] El Paso further argues that Sempra fails to recognize that a shipper that uses IHSW service in conjunction with another service purchases two different services and should pay for both.[466]

Commission Determination

315. The Commission affirms the Presiding Judge on the use of the 100 percent load factor for Rate Schedule FTH-16 as the basis for designing Rate Schedule IHSW rates. The Commission agrees with the Presiding Judge that the FT-H service is the service that most closely approximates the hourly flexibility provided by IHSW service. In addition, the Commission finds that based on the *prima facie* case presented by El Paso, its proposed IHSW rate design is just and reasonable. Further, the Presiding Judge found, and the Commission affirms, that Commission policy permits one-part interruptible transportation rates derived from a comparable firm service.[467]

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[463] *Id.* at 22-24 (citing Ex. SG-1 (Diemer) at 7:9-12).

[464] SoCal Gas/San Diego Brief Opposing Exceptions at 42-43.

[465] El Paso Brief Opposing Exceptions at 86 (citing *September 5 Order,* 124 FERC ¶ 61,227 at P 103).

[466] *Id.* at 86-87.

[467] *See, e.g., Elizabethtown Gas,* 10 F.3d 866, 871 (affirming decision that a 100 percent load factor interruptible rate adequately accounted for the cost and quality difference between interruptible shippers and firm shippers); *Arkla,* 67 FERC at 61,646

(continued…)

316. The Commission affirms the Initial Decision and finds that the IHSW service is a separate and supplemental service; IHSW is a swing service while Rate Schedules FT-1 and IT-1 are transportation services with hourly flow requirements. Thus, it is appropriate for different costs to be allocated to the different services. Moreover, the Commission affirms the Initial Decision and finds that there is no double recovery of costs for the IHSW service (as there are no costs allocated to the IHSW service). As noted above, El Paso proposed an IHSW rate design that was based on the FT-H rate. El Paso, for the FT-H services, identified A&G costs which it proposed to allocate to these hourly services and away from other services.[468]

5. Rate Design for Within Basin Zone (Stipulated Issue VII.F)

317. El Paso proposes to assign positive miles to all paths, including contra-flow segments, in the Within Basin zone.[469] El Paso explains that it is appropriate to have a different methodology for assigning mileage to contra-flow segments for its mainline zones and its production area zone because the former involve discrete, identifiable contra-flow segments in zones that have substantial forward-haul deliveries whereas the latter involves a system of highly reticulated facilities. El Paso further explains that if it assigns zero mileage to the production area contra flows, the Within-Basin zone would be allocated little, if any cost. El Paso contends that because the production areas contain almost 2,000 miles of pipe and 35 percent of its total system compression horsepower, such a result would produce unreasonable results.

318. Indicated Shippers argue that El Paso's proposal to allocate costs for contra-flow segments in the Within Basin zone is inconsistent with El Paso's past practice and is inconsistent with the way El Paso allocates costs to all other zones. Therefore, Indicated Shippers argue that El Paso's proposal discriminates against Within Basin shippers as compared to mainline shippers.[470]

319. Southwestern argues that El Paso failed to present a coherent, much less consistent, case for revising its method for calculating miles in the Within Basin zone.[471]

(stating that "a 100 percent load factor rate, being a fully allocated rate, is the starting point for interruptible rate design").

[468] Ex. EPG-59.

[469] El Paso Initial Br. at 89-91.

[470] Indicated Shippers Initial Br. at 24-25.

[471] Southwestern Initial Br. at 8, 10-13.

Southwestern argues that El Paso's direct case ignores a key element of El Paso's mileage model that tends to overstate the distance that gas in the production area actually moves for contracts with a pool receipt point. Southwestern also argues that El Paso's witnesses testifying in defense of El Paso's proposal contradict each other. In addition, Southwestern argues that because of the reticulated nature of the facilities in the production areas, it is more likely that many segments will experience contra flows. Southwestern argues that because El Paso failed to meet its burden of proof, its proposed revisions should be rejected.

Initial Decision

320. The Presiding Judge found that, consistent with his ruling for transportation on El Paso's mainlines, it is impossible to determine the actual source of gas or to trace the actual delivery path for most gas transported over the El Paso system.[472] He further found that the Within Basin zone pipeline and compressor networks are substantially more complex, integrated and reticulated than the mainline system. He therefore found that it was appropriate to assign positive miles to all Within Basin contract-path segments, including those using contra flows.

321. The Presiding Judge agreed with Indicated Shippers and Southwestern that El Paso's proposal to assign zero miles to mainline contract-path contra-flow segments while assigning positive miles to similar Within Basin contract-path segments is unjust and unreasonable. The Presiding Judge stated that he had previously addressed this disparity by requiring El Paso to assign positive miles to mainline contra-flow segments.[473] Accordingly, he found the issue is moot.

322. The Presiding Judge disagreed with Indicated Shippers' and Southwestern's contentions that El Paso had not satisfied its burden of proof because it did not demonstrate that operational changes had occurred since El Paso began assigning zero mileage to contra-flow segments. The Presiding Judge noted that El Paso's position was that in previous cases, it had under-allocated costs to the Within Basin zone. The Presiding Judge found that the operational changes were immaterial to El Paso's burden of proof in this proceeding.[474]

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[472] ID, 139 FERC ¶ 63,020 at P 195.

[473] *Id.* P 196.

[474] *Id.*

Briefs on Exceptions

323. El Paso argues that the Presiding Judge erred by implying that positive miles should be assigned to all mainline contra-flow segments.[475] Indicated Shippers and Texas Gas Service request clarification of the Presiding Judge's finding with respect to assigning positive miles to contra-flow segments because El Paso did not propose assigning positive miles to contra-flow segments.[476]

324. Southwestern argues that the Presiding Judge erred in holding that El Paso met its burden of proof for assigning positive miles to Within Basin contra-flow segments.[477] Edison and Texas Gas Service argued that the contra-flow issue should be resolved in a manner consistent with their respective proposals on allocating costs and designing rates for El Paso's mainline facilities.[478]

Briefs Opposing Exceptions

325. El Paso argues that in the instant proceeding, it is not proposing to justify its treatment of Within Basin miles in its mileage study on the basis of operational changes; rather, it reviewed its previous method of allocating costs to the production zone and determined that it understated the costs that should be allocated to the Within Basin zone.[479]

Commission Determination

326. In this proceeding, El Paso proposes to assign positive miles to contra-flow segments in its Within Basin zone but does not propose to assign positive miles to contra-flow segments for its mainline zone. El Paso has the burden under NGA section 4 to support its proposal and show that the resulting rates will be just and reasonable. The Commission finds that El Paso has not met its burden.

327. Under its zone-of-delivery methodology, El Paso is using the same Dth-mileage model it used in its previous two rate cases, updated with test-period billing

[475] El Paso Brief on Exceptions at 16.

[476] Indicated Shippers Brief on Exceptions at 19-21; Texas Gas Brief on Exceptions 65-66.

[477] Southwestern Brief on Exceptions at 4.

[478] The arguments are not repeated here.

[479] El Paso Brief Opposing Exceptions at 69.

determinants.[480] As explained above, the Commission finds that El Paso's proposed Dth-mileage study, as applied for zones other than Within Basin, is based on a thorough and detailed analysis of transportation paths for the base period using the receipt points (or pools) and delivery points specified in each firm shipper's contracts.

328. With its proposal to assign positive mileage to contra flows in the production areas, El Paso is changing the methodology. Specifically, El Paso is shifting additional costs to shippers using the production zone. As with its equilibration proposal, El Paso did not provide empirical evidence to support its proposal. Further, the arguments proffered by El Paso were disjointed: El Paso is proposing to assign more mileage to production areas flows while freely admitting that the production area is so reticulated that it fully exploits displacement opportunities.[481] Thus, as stated above, it is incongruous for El Paso to propose and fully support a zone-of-delivery methodology based on a detailed Dth-mileage study and then make a significant modification to that methodology without providing the same level of empirical support.

329. The Commission concurs with the Presiding Judge that El Paso did not have to demonstrate that operational changes had occurred in order to propose a change in the methodology it uses to allocate costs to contra flows in the production areas. However, El Paso must support its proposed rates. Although it is possible to develop a proposal with different methodologies for allocating mileage to contra flows for the mainline and production areas, El Paso did not present such a proposal here.

330. As discussed below, the Commission requires El Paso to submit a compliance filing. In compliance with the Commission's finding herein, El Paso is required to revise its Dth-mileage study contained in Ex. EPG-108 so that the contra flows in the Within Basin zone are assigned zero mileage. El Paso should file the revised Dth-mileage study and all supporting workpapers.

6. <u>Level of Variable Costs Classified as Mileage-Based (Stipulated Issue VII.E)</u>

331. El Paso's transmission costs are first classified as either fixed or variable and then as non-mileage-based or mileage-based.[482] All of its variable costs, which are approximately $30 million, are treated as mileage-based and recovered through its zone-of-delivery usage charges. El Paso states that its zone-differentiated usage charge helps

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[480] Ex. EPG-107 at 21.

[481] Ex. EPG-145 at 4.

[482] Ex. EPG-107 at 6-7.

produce an overall end result for its combined reservation, usage and fuel rates that is reasonable. El Paso further states that it has attempted to strike a reasonable balance in these rates that reflects distance by a modest, but appropriate, degree.[483]

332. Consistent with its overall support for a postage-stamp rate design, Edison contends that no costs should be based on distance.[484] Edison notes that El Paso's compressor fuel costs are allocated on a postage-stamp basis. Edison argues that El Paso's non-fuel compressor costs, which relate primarily to compressor station operations and maintenance, should be treated on the same basis as El Paso's fuel costs. Therefore, Edison argues that El Paso's variable costs should be treated as non-mileage-related.

333. SoCal Gas/San Diego argue that, based on a detailed analysis of the functions of each of El Paso's compressor stations, about $9 million of the variable costs should not be classified as mileage-related costs.[485] SoCal Gas/San Diego argue that the costs associated with compressor stations, whose primary purpose is to bring pooled supplies of gas up to operating pressures, should not be considered mileage-related. They also argue that costs associated with a storage area compressor station should not be considered as mileage-related, and that the costs associated with the abandoned Tucson and Deming compression stations should not be reflected in the cost of service.

Initial Decision

334. The Presiding Judge agreed with SoCal Gas/Diego on this issue.[486] The Presiding Judge noted that although El Paso has historically classified its compressor costs as mileage-related and recovered them through usage charges, SoCal Gas/San Diego rebutted the presumption that such classification remains just and reasonable. He also noted that the record indicates that Within Basin compressor stations increase pooled gas pressures to mainline-compatible levels, but do not otherwise facilitate mainline transportation. The Presiding Judge therefore found that non-labor costs associated with those stations do not vary with distance and should not be recovered through the usage charge. In addition, he found that non-labor costs associated with the storage compressor station do not vary with distance and should not be recovered through the usage charge. The Presiding Judge further found that it is unjust and unreasonable for El Paso to include variable non-labor expenses associated with the Deming and Tucson compressor

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[483] El Paso Initial Br. at 89.

[484] Edison Initial Br. at 56-58.

[485] SoCal Gas/San Diego Initial Br. at 31-34.

[486] ID, 139 FERC ¶ 63,020 at P 188.

stations because those facilities should not be considered used and useful for prospective ratemaking purposes.

335. The Presiding Judge agreed with Edison that it would be logically consistent for El Paso to allocate all variable costs associated with compressor operations on the same basis, i.e., a postage-stamp basis. However, he noted that since El Paso did not propose postage-stamp rates for all such costs, El Paso's historical methodology enjoys a presumption of justness and reasonableness.[487]

Briefs on Exceptions

336. Edison argues that while the Presiding Judge's ruling with respect to about one-third of El Paso's variable compressor station costs is an improvement on El Paso's proposal, the Initial Decision did not go far enough.[488] Edison argues that all variable costs should be allocated on a postage stamp basis. Edison asserts that the rationale adopted in the Initial Decision to accept El Paso's use of contract paths for cost allocation has no possible applicability to variable costs. Edison argues that since the Presiding Judge recognized the contract paths do not reflect actual gas flows, El Paso's incurrence of variable costs is not correlated in any way with contract paths, and variable costs should not be distance-based at all. Edison argues that allocating all variable costs on a postage-stamp basis would be consistent with El Paso's long-standing treatment of one subset of variable costs -- fuel. Edison asserts that since El Paso's compressor station fuel costs are allocated on a postage stamp basis due to the lack of relationship between distance and fuel consumption, the other variable costs associated with compressor stations should be handled in the same way.

Briefs Opposing Exceptions

337. Texas Gas Service argues that there is no support for Edison's argument that all variable costs should be allocated as non-distance based costs. In addition, Texas Gas Service argues that it appears that Edison raised this argument for the first time in its brief on exceptions. As such, the argument is inappropriate and should be discarded.[489]

[487] *Id.* P 189.

[488] Edison Brief on Exceptions at 61-63.

[489] Texas Gas Service Brief Opposing Exceptions at 72.

Commission Determination

338. The Commission affirms the Presiding Judge's finding with respect to cost classification for El Paso's storage compressor station and those compressor stations whose purpose is to increase the pressure of pooled gas supplies to the pressure level of mainline facilities. Based on SoCal Gas/San Diego's detailed analysis,[490] the Commission finds El Paso's proposal to continue to classify costs associated with these compressor stations as mileage-based is no longer just and reasonable. The Commission further finds that SoCal Gas/San Diego's proposal to classify those costs as non-mileage-based is just and reasonable. El Paso's compliance obligation is addressed below. Finally, based on our rulings *supra*, the issue of how to treat variable costs associated with the Deming and Tucson compressor stations is moot.

339. Edison argues that all variable costs should be non-mileage based. However, because no party presented evidence as to the appropriate classification of the variable costs for the remaining compressor stations, the Commission is required to accept El Paso's classification of those costs as mileage-based. As is noted above, any participant proposing postage-stamp rates bears sequential NGA section 5 burdens to prove that it is unjust and unreasonable for El Paso to continue to establish rates based on state-defined zones, and that postage-stamp rates are a just and reasonable alternative for the pipeline. Edison has not met that burden.

7. Allocation of Daily Imbalance Costs (and Automatic Daily Balancing Service) (Stipulated Issue VII.H)

340. At hearing, SoCal Gas proposed a new Automatic Daily Balancing Service (ADBS) designed to allocate daily transportation imbalance costs to shippers using El Paso's system to manage their daily imbalances. El Paso agreed that there is significant daily imbalance activity on its system that used system capacity and assets, and that the shippers causing the imbalance should be responsible for the associated costs.[491] However, El Paso objected to a feature of SoCal Gas' proposal that would require it to establish a regulatory asset or liability to account for potential under/over-recoveries. Instead, El Paso proposed to allocate no costs to the ADBS service, but to return any ADBS revenues to maximum recourse rate shippers. APS, Indicated Shippers, Texas Gas Service and Freeport/Apache argue that SoCal Gas/San Diego have failed to demonstrate that El Paso's current daily imbalance cost allocation is unjust and unreasonable. ACC/Southwest Gas, UNS/Tucson Electric, and Municipal Customers

[490] Ex. SCG-11 at 7-10; Ex. SCG-12; Ex. SCG-13.

[491] ID, 139 FERC ¶ 63,020 at P 204 (citing Ex. EPG-217 at 5-11).

maintain that SoCal Gas/San Diego have failed to demonstrate that the alternative ADBS proposal is just and reasonable.

Initial **Decision**

341. The Presiding Judge found that SoCal Gas/San Diego failed to meet its burden under NGA section 5 to demonstrate that El Paso's existing methodology was no longer just and reasonable. The Presiding Judge noted that the Commission has elsewhere found that daily imbalances were sufficiently addressed through El Paso's existing scheduling penalties and daily imbalance penalties.[492] He noted that the Commission found that El Paso has sufficient deterrents to police daily balancing, through daily overrun and variance charges and hourly balancing penalties.[493]

Briefs on Exceptions

342. SoCal Gas/San Diego challenge the Presiding Judge's rejection of their imbalance proposal, noting that although the El Paso tariff requires scheduled and delivered quantities to balance, customers create and carry imbalances, relying on pipeline flexibility.[494] SoCal Gas/San Diego disagree with the Presiding Judge's burden-of-proof analysis, claiming that this is the first time that El Paso's balancing practices have been considered in a rate filing context. According to SoCal Gas/San Diego, El Paso's proposal misallocates costs to shippers who benefit from imbalances that use system resources. According to SoCal Gas/San Diego this creates material variations in costs associated with imbalances, causing customer subsidies by embedding the cost of accommodating imbalances in transportation rates.[495]

343. SoCal Gas/San Diego contest whether the Commission's prior approvals of El Paso's imbalance procedures apply, because this is the first El Paso rate case since full requirements customers converted to contract demand service. According to SoCal Gas/San Diego, the reforms were designed to work together to ensure that customers

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[492] *Id.* PP 220-221 (citing *March 23, 2006 Order,* 114 FERC ¶ 61,305 at PP 118, 125 and *El Paso Natural Gas Co.*, 121 FERC ¶ 61,265 (2007) (order on technical conference) (addressing El Paso request to establish a non-critical condition daily scheduling penalty) (*December 20, 2007 Order*)).

[493] *Id.* PP 220-221 (citing *March 23, 2006 Order,* 114 FERC ¶ 61,305 at P 118; *December 20, 2007 Order,* 121 FERC ¶ 61,265 at PP 27-28, 30, 32).

[494] SoCal Gas/San Diego Brief on Exceptions at 28.

[495] *Id.* at 29-33.

would contract properly and bear the costs of system use, and schedule properly.[496] SoCal Gas/San Diego argue that the Initial Decision expressly found that imbalances in the East of California zones appear "chronic" and "purposeful," created "(at no charge) in lieu of paying for no-notice, daily balancing, [park and loan] or storage services that provide nominating/scheduling flexibility."[497] On that basis, SoCal Gas/San Diego question the Presiding Judge's reliance on the Commission's earlier finding that El Paso "already has sufficient deterrents in place."[498]

344. SoCal Gas/San Diego defend the analysis of their witness Jones from the Presiding Judge's conclusions that the analysis overstated the magnitude of imbalances outside of critical conditions, by noting that their analysis reflected differences between scheduled and delivered quantities, by delivery code (D-Code).[499] SoCal Gas/San Diego state that quantities nominated to clear a prior imbalance are both scheduled and delivered so there is no difference. Consequently, SoCal Gas/San Diego state that Jones' calculations do not reflect new imbalances created to address a prior imbalance.[500] SoCal Gas/San Diego also criticize the Presiding Judge for failing to address their claim that some customers derive substantial benefits from imbalances, including cost avoidance.[501] According to SoCal Gas/San Diego, it is cheaper to buy balancing services than to build behind the meter storage facilities. SoCal Gas/San Diego state that any imbalance, even if within a shipper's contract demand, imposes costs on others, because the customer has no right to the imbalance in the first place.[502] According to SoCal Gas/San Diego, El Paso's existing rate design is not just and reasonable because it rewards customers that create imbalances in violation of their tariff obligations while imposing costs on customers that invest in balancing services and facilities.

345. Furthermore, SoCal Gas/San Diego state that balancing arrangements between El Paso and interconnected pipeline systems are of a different kind and quality than the end-

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[496] *Id.* at 35 (citing *March 23, 2006 Order*, 114 FERC ¶ 61,305 at P 29).

[497] *Id.* at 38 (citing ID, 139 FERC ¶ 63,020 at P 223 & n.213).

[498] *Id.* at 36 (citing ID, 139 FERC ¶ 63,020 at P 220; *March 23, 2006 Order*, 114 FERC ¶ 61,305 at P 118).

[499] *Id.* at 39-44 (citing ID at P 225).

[500] *Id.* at 40.

[501] *Id.* at 42.

[502] *Id.* at 45.

use driven balancing needs of D-Codes governed by a Pre-Determined Allocation agreement (PDA), such as electric generators and distribution company city-gates.[503] SoCal Gas/San Diego argue that the Presiding Judge's sweeping declaration rejecting differentiation between Operational Balancing Agreement (OBA) and PDA D-Codes vis-à-vis imbalances/confirmation differences was not based on consideration of the practical effect of Mr. Jones' approach, as the purpose of his analysis was to unbundle El Paso's fixed costs between transportation and balancing functions. In short, SoCal Gas/San Diego contend that El Paso's current rates embed all of the system costs of accommodating daily imbalances in the transportation rates, even though some shippers require and benefit from imbalances to a far greater degree than do others.[504]

346. SoCal Gas/San Diego argue that, under its proposed ADBS, customers taking daily balancing service from the pipeline will pay a reasonable rate for doing so. SoCal Gas/San Diego attempt to distinguish their proposal from El Paso's proposed daily scheduling penalties based on its proposed "cumulative component," which applies to large accumulated imbalances within a month. SoCal Gas/San Diego state that this component functions like an "automatic Park and Loan service or storage service."[505] SoCal Gas/San Diego argue that ignoring customer imbalance behavior in the allocation of El Paso's fixed costs is inconsistent with the principle that cost causation should be tied to cost responsibility, and is therefore unjust and unreasonable.[506] According to SoCal Gas/San Diego, the proposed ADBS is a modest cost-based service charge designed to recover El Paso's cost of providing balancing service from those using the service.

347. Texas Gas Service opposes SoCal Gas/San Diego's claim that El Paso's existing imbalance cost allocation is unjust and unreasonable, stating that El Paso treats the fixed costs of facilities that it uses to manage shippers' daily imbalances as system costs that are embedded in El Paso's zonal cost allocation.[507] Texas Gas Service argues that all shippers are out of balance to some degree almost every day, and cites the Commission's

[503] *Id.* at 48 (citing Ex. SCG-28 and Ex. SCG-29).

[504] *Id.* at 48-49.

[505] *Id.* at 51-52.

[506] *Id.* at 58.

[507] Texas Gas Service Brief on Exceptions at 70.

prior approval of El Paso's imbalance procedures.[508] Texas Gas Service objects to the Presiding Judge's claim that shippers purposefully and intentionally create daily imbalances as unsupported and dicta.

348. Texas Gas Service contests SoCal Gas/San Diego's Witness Jones's statement that shippers using the El Paso system for balancing could benefit by engaging in arbitrage related to the commodity price, stating that this ability does not apply to its service because it is prohibited from keeping such financial gains by regulators.[509] Texas Gas Service counters the claim that shippers could benefit from El Paso's imbalance procedures by avoiding the need to construct balancing facilities, noting that, while its witness Crisp agreed that there could be significant costs associated with constructing balancing-related assets, it may not be physically possible to construct storage or other balancing facilities behind a city gate or to obtain the necessary approvals. Texas Gas Service argues that the Commission should reject El Paso's Witness Rezendes' statement that "customers that need no-notice or daily balancing service simply take it without paying for it, by drafting or packing El Paso's system on a daily basis…effectively using more system capacity and taking a premium service without paying an incremental charge," because the Presiding Judge has found that El Paso's existing imbalance cost allocation is just and reasonable after reviewing the record and Rezendes' testimony.[510]

Briefs Opposing Exceptions

349. APS and ACC/Southwest Gas point to the stipulated issues in this proceeding which indicate that the burden of proof is on SoCal Gas/San Diego to support new balancing procedures.[511] Texas Gas Service also argues that SoCal Gas is attempting to change the status quo of a service provided by El Paso and therefore has the burden of

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[508] *Id.* (citing Ex. SCG-18 at 41:21-22; Tr. at 4344:4-6; Ex. SWG-55 at 40:20-41:4; ID, 139 FERC ¶ 63,020 at PP 209, 214, 218-219; *March 23, 2006 Order,* 114 FERC ¶ 61,305 at P 118; *December 20, 2007 Order,* 121 FERC ¶ 61,265 at PP 27, 30).

[509] *Id.* at 72-73.

[510] *Id.* at 74 (citing Ex. EPG-217 at 8:22-9:2).

[511] *See* APS Brief Opposing Exceptions at 14-15 (citing stipulated issue VII.H: Has Southern California Gas Company met its section 5 burden of demonstrating that the existing allocation of daily imbalance costs is unjust and unreasonable, and if so whether Southern California Gas Company has met its burden of demonstrating that an auto daily balancing service and related charge is just and reasonable). *See also* ACC/Southwest Gas Brief on Exceptions at 42-43.

proof under the NGA.[512] UNS/Tucson Electric argue that SoCal Gas/San Diego should not be able to impose a charge indirectly that El Paso tried to impose directly and failed.[513]

350. These parties cite the *March 23, 2006* and *December 20, 2007 Orders* that the Presiding Judge described as definitive regarding existing penalties and services to address daily imbalances on El Paso's system that are not related to strained operating conditions (SOC) or critical operating conditions (COC).[514] Texas Gas Service argues that SoCal Gas' exception to the Presiding Judge's reliance on prior Commission orders is based on a strained interpretation of those orders and should be rejected.[515] APS argues that the Presiding Judge properly relied upon the Commission's findings in the two prior orders, after concluding that SoCal Gas/San Diego did not argue there has been a substantial change in circumstances on the El Paso system since the 2006/2007 Commission determinations rejecting El Paso's requests to implement a non-SOC/COC daily imbalance penalty.[516] ACC/Southwest Gas argue that El Paso uses line pack to provide FT-H service and HEEN[517] flexibility to allow shippers to vary their hourly flows; thus, some portion of this cost is already reflected in the allocation of system costs to FT-H service, HEEN flexibility, and other system deliverability needs.[518] ACC/Southwest Gas state that most shippers and/or delivery point operators at PDA points are subject to daily imbalance penalties that apply during critical periods, and the

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[512] Texas Gas Service Brief Opposing Exceptions at 84.

[513] UNS/Tucson Electric Brief Opposing Exceptions at 28.

[514] Freeport/Apache/Municipal Customers Brief Opposing Exceptions at 4-5 (citing *March 23, 2006 Order,* 114 FERC ¶ 61,305; *December 23, 2007 Order,* 121 FERC ¶ 61,265); *see also* Texas Gas Service Brief Opposing Exceptions at 74; APS Brief Opposing Exceptions at 15-16; UNS/Tucson Electric Brief Opposing Exceptions at 23-26.

[515] Texas Gas Service Brief Opposing Exceptions at 74-76.

[516] APS Brief Opposing Exceptions at 15-17.

[517] *See* ID, 139 FERC ¶ 63,020 at P 221 n.210 (explaining that HEEN (Hourly Enhanced Entitlement Nominations) is an enhanced scheduling right under Rate Schedules FT-1, FT-H, NNTD and NNTH designed to increase service flexibility by permitting shippers to assign a portion of their daily entitlements to support non-uniform flows).

[518] ACC/Southwest Gas Brief Opposing Exceptions at 44.

Commission has rejected El Paso's proposals to institute a daily scheduling penalty during non-critical periods on top of the non-critical day hourly penalties.[519]

351. UNS/Tucson Electric argue that SoCal Gas' ADBS proposal is equivalent to El Paso's non-critical daily scheduling penalty tariff provision that the Commission has previously rejected twice.[520] UNS/Tucson Electric point out similarities between SoCal Gas' ADBS charge proposal and a proposal submitted by Natural Gas Pipeline Company of America that was rejected by the Commission.[521] UNS/Tucson Electric state that the Commission found no difference between a penalty and such a charge, given both are designed to deter certain conduct.

352. SoCal Gas/San Diego contest Texas Gas Service's exception that imbalances are not created purposefully and intentionally, arguing that the Presiding Judge's use of the aforementioned language is amply supported by the evidence in this proceeding.[522]

Commission Determination

353. The Commission affirms the Presiding Judge's findings, as discussed below. The Commission agrees with the Presiding Judge that SoCal Gas/San Diego bear the burden of proof to show changed circumstances that demonstrate that El Paso's scheduling practices are no longer just and reasonable, based on prior orders approving El Paso's current scheduling procedures.[523] The Presiding Judge found that ADBS is a mandatory charge that would be automatically imposed by the pipeline on top of the charge for firm service. Furthermore, although the Presiding Judge did not find that ADBS is a penalty because it was not designed to deter behavior under a strict reading of the Commission's definition, the Presiding Judge nevertheless found that the ADBS is a "functional equivalent" of the non-SOC/COC daily imbalance penalty the Commission rejected in

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[519] *Id.* at 55.

[520] UNS/Tucson Electric Brief Opposing Exceptions at 21-24.

[521] *Id.* at 25-26 (citing *Natural Gas Pipeline Co. of America*, 101 FERC ¶ 61,200 (2002) (*Natural Gas Pipeline II*).

[522] SoCal Gas/San Diego Brief Opposing Exceptions at 50.

[523] Based on our prior approvals of El Paso's scheduling procedures, we affirm the Presiding Judge's finding that proponents seeking changes bear the burden under section 5 of the NGA to demonstrate that the existing procedures are no longer just and reasonable due to changed circumstances, and that their proposal is just and reasonable, consistent with the participants' Joint Stipulation.

2007.[524] In the *December 20, 2007 Order,* the Commission rejected an El Paso request to establish a non-critical condition daily scheduling penalty, stating:

> The Commission, consistent with the [*March 23, 2006 Order*,] finds that the addition of a non-critical daily scheduling penalty would prevent shippers from effectively utilizing HEEN and the premium services established in the [2006 Rate Case Settlement], and at the same time, from minimizing or avoiding the incurrence of penalties.
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> * * *
>
> El Paso has at its disposal services and penalties, including hourly and monthly contract restrictions, to encourage proper scheduling and contracting. The Commission determined as much in the [*March 23, 2006 Order,*] and that reasoning remains applicable here.[525]

354. Consequently, the Commission has already reviewed El Paso's existing scheduling procedures and found them adequate to address both daily and monthly scheduling practices, without a penalty mechanism similar to that sought in this proceeding. Furthermore, in Order No. 637-A, the Commission reaffirmed its position against penalties when it denied requests to change the requirement that penalties be justified solely on the basis of system reliability, stating:

> The pipelines themselves recognize that "the fundamental purpose of penalties and [operational flow orders (OFO)] is to protect the reliability of service to all shippers...." It was precisely this purpose that the Commission recognized in Order No. 636, when it permitted pipelines to develop and utilize OFOs and penalties as system management tools. Thus, the requirement that pipelines impose penalties "only to

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[524] ID, 139 FERC ¶ 63,020 at PP 229-231 (citing *Natural Gas Pipeline II,* 101 FERC ¶ 61,200 at P 79: "The Commission considers a penalty to be any *charge imposed* by the pipeline on a shipper that is *designed* to *deter* the shipper from engaging in *certain conduct*. A service, in contrast, is a pipeline *offering* a shipper . . . has *chosen* to *purchase*" (emphasis in Initial Decision)).

[525] *December 20, 2007 Order,* 121 FERC ¶ 61,265 at PP 27, 30 (citation to *March 23, 2006 Order,* 114 FERC ¶ 61,305 at P 118 omitted).

> the extent necessary to prevent the impairment of reliable service" simply reflects a formalized requirement that pipelines use penalties exclusively for their intended purpose. The Commission is not permitting pipelines to impose penalties for other purposes, such as enforcement of contract obligations, where unrelated to system reliability.... The Commission reiterates that penalties may be required, especially during critical periods when system reliability is most in jeopardy.[526]

355. Thus, the Commission does not permit a pipeline to impose penalties on shippers where the shipper is unable to avoid the penalty. The Commission has reviewed and rejected arguments similar to those presented by SoCal Gas/San Diego when it approved El Paso's scheduling procedures but rejected El Paso's proposal for a non-critical daily scheduling penalty.[527] The Commission finds that El Paso's existing scheduling procedures are just and reasonable, and that SoCal Gas/San Diego has failed to meet its burden to demonstrate that El Paso's existing procedures are not just and reasonable. SoCal Gas/San Diego failed to demonstrate a substantial change in circumstances on the El Paso system since the 2006/2007 Commission determinations that rejected the non-SOC/COC daily imbalance penalty.

356. The Commission reaches this conclusion for the following reasons. The proponents argue that the imbalances persisted on the system despite the hourly scheduling penalties, daily SOC/COC imbalance penalties, available services and contract restrictions on the system. The Presiding Judge cited testimony that, although no notice service and other alternatives were available, shippers still carried imbalances to

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[526] *Regulation of Short-Term Natural Gas Transportation Services, and Regulation of Interstate Natural Gas Transportation Services*, Order No. 637-A, FERC Stats. & Regs. ¶ 31,099, at 31,608-31,609 (2000) (footnote omitted); *see also Columbia Gas Transmission Corp.*, 115 FERC ¶ 61,134, at P 9 (2006). The Presiding Judge noted that SoCal Gas/San Diego did not attempt to demonstrate that failing to implement ADBS would impair reliable service on the El Paso system, consistent with their position that ADBS is not a penalty. ID, 139 FERC ¶ 63,020 at P 231 n.222.

[527] 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 March 23, 2006 Order,* 114 FERC ¶ 61,305 at P 118; *December 20, 2007 Order,* 121 FERC ¶ 61,265.

find that the imbalances were persistent and purposeful.[528] However, as noted above, Texas Gas Service states all shippers are out of balance to some degree almost every day and that building balancing facilities behind a city gate can be costly and may be physically impossible. In addition, the Presiding Judge also noted numerous claims that SoCal Gas/San Diego significantly overstated the level of daily imbalance activity. The Presiding Judge faulted the analysis for failing to correct for imbalance-correcting nominations, which occur because El Paso's tariff does not require shippers to reconcile imbalances within a month.[529] SoCal Gas/San Diego's analysis also failed to account for offsetting drafts and packs and receipt and delivery imbalances that are part of the same transaction. Under SoCal Gas/San Diego's proposal California shippers are exempt from the charge, even though they carried imbalances despite having balancing facilities available beyond the delivery point. Finally, the Presiding Judge noted that the evidence demonstrated that El Paso's existing procedures had not eliminated imbalances on the El Paso system since they were approved in the *March 23, 2006 Order* and *December 20, 2007 Order*.[530] However, the Presiding Judge also noted evidence that imbalance levels were overstated and the lack of data pre-dating the existing procedures. Thus, the Presiding Judge could not find that the existing procedures did not reasonably deter imbalance activity.

357. The Commission concurs in these findings, and finds that SoCal Gas/San Diego have failed to demonstrate that the existing procedures are not just and reasonable.

358. The Presiding Judge also found that SoCal Gas/San Diego failed to demonstrate that their proposal is just and reasonable due to the failure to address imbalances at delivery sites governed by an OBA. While the Commission need not address the alternate proposal, since we agree with the finding that El Paso's existing procedures have not been shown to be unjust and unreasonable, the Commission nevertheless agrees that any proposal should not be unduly discriminatory under the NGA. As with El Paso's prior attempts to impose scheduling penalties that cannot be avoided, the SoCal Gas/San Diego proposal fails for similar reasons. In the past, the Commission has stated its objection to scheduling procedures that would place shippers in a position where it would

[528] ID, 139 FERC ¶ 63,020 at P 223 (citing Ex. SCG-18 at 41-43; Ex. EPG-217 at 5-6, 8-9; Ex. SCG-23; Ex. SCG-53 (bar chart showing balance activity among El Paso shippers)).

[529] *Id.* P 225 (surmising the error could be as much as 50 percent).

[530] *March 23, 2006 Order,* 114 FERC ¶ 61,305; *December 20, 2007 Order,* 121 FERC ¶ 61,265.

be extremely difficult to avoid some kind of penalty.[531] In this instance, SoCal Gas/San Diego proposes an ADBS charge that is effectively unavoidable and automatic for the delivery points that lack balancing facilities, but not for service at delivery points that happen to have such facilities, even though these latter points nevertheless still carry imbalances in the normal course of business. The Commission concludes such an approach is unjust and unreasonable, and unduly discriminatory.

VII. Risk Sharing for Costs of Unsubscribed Capacity and Discount Capacity

359. El Paso proposed a significant discount adjustment to the billing determinants it proposes to use both to allocate its cost of service among services and rate zones and to design per unit rates. El Paso also proposed to include the costs of its unsubscribed capacity in its rate design, so that its proposed rates would recover 100 percent of its cost of service assuming market conditions remain the same as in the test period. A number of parties opposed El Paso's billing determinant proposals, arguing El Paso should be required to share in the cost of its unsubscribed and discounted capacity. In the preceding section, we hold that El Paso must allocate its costs among zones based on unadjusted billing determinants. Therefore, the only issue addressed in this section is whether El Paso's per unit rates should be designed in a manner that requires it to absorb a portion of its cost of service by denying it a full discount adjustment or unsubscribed capacity recognition.[532]

360. The parties examined 12 stipulated issues related to the sharing of the risks of discounted or unsubscribed capacity. The Presiding Judge discussed and made findings with regard to four of these issues[533] and found the remaining issues were resolved by one of the four findings.[534] The Commission clarifies the parties' burden of proof with

[531] *El Paso Natural Gas Co.*, 139 FERC ¶ 61,096, at P 47 (2012).

[532] Issues concerning Article 11.2 and whether El Paso may seek a further adjustment based on its failure to recover the maximum rate under the 1996 Settlement rates are addressed later in this order.

[533] Stipulated Issues VIII.A (burden of proof under NGA sections 4 and 5 (ID at P 253)); VIII.B (cost reductions for unsubscribed capacity (P 263)); VIII.G (prudence of Phase III of the Power-Up Project (P 283)); and VIII.H (estoppel of Phase III prudence claims (P 284)).

[534] The Presiding Judge found that the remaining issues were resolved in the discussion of Stipulated Issue VIII.B: Issues VIII.C (cost reductions for discounts); VIII.D (limits to California discounts); VIII.E (removal of costs of facilities used for discounted service to California); VIII.F (criteria for determining whether El Paso should bear the risk for unsubscribed and/or discounted capacity); VIII.I (causes of unsubscribed

(continued…)

respect to the billing determinants to be used to design El Paso's rates and affirms the Initial Decision on each of the Presiding Judge's other findings.

A. Section 4/Section 5 Burden of Proof (Stipulated Issue VIII.A)

Initial Decision

361. The Presiding Judge found that El Paso bears an overall NGA section 4 burden to prove its proposed rate increase is just and reasonable, including the billing determinants upon which the rates should apply and support for the proposed discount adjustment. Citing the *Selective Discounting Policy*,[535] the Presiding Judge found that El Paso bears an NGA section 4 burden to establish the billing determinants to which the rates should be applied and affirmatively establish that any discounts were required by competition. If El Paso satisfies these requirements, both the discounting and the discount amounts acquire a rebuttable presumption that they are just and reasonable. The burden then shifts to any opposing participants to rebut the presumptions. Any opposing party must affirmatively demonstrate it is just and reasonable (a) to deny El Paso the full indicated discount adjustment and (b) to impose any resulting revenue shortfall on the pipeline.

362. The Presiding Judge then found that no participant argued El Paso's discounts and unsubscribed capacity are not attributable to competition, and that the record is overwhelming and unequivocal that the discounts and unsubscribed capacity were attributable to market competition.

Briefs on Exceptions

363. UNS/Tucson Electric take exception to the fact that the Presiding Judge did not distinguish between the different burdens of proof applicable to discount adjustments and unsubscribed capacity. UNS/Tucson Electric note that the Presiding Judge solely discussed the Commission's discount adjustment policy, but applied that analysis not only to discounted adjustments but also to unsubscribed capacity. UNS/Tucson Electric

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and discounted capacity and benefits to El Paso's shippers); VIII.J (calculation of any El Paso share of unsubscribed capacity adjustment); VIII.K (calculation of any El Paso share of discounted capacity adjustment); VIII.L (alternate rate design if El Paso shares unsubscribed or discounted capacity adjustment).

[535] ID, 139 FERC ¶ 63,020 at P 253 (citing *Policy for Selective Discounting By Natural Gas Pipelines*, 111 FERC ¶ 61,309, at P 59 (2005) (*Selective Discounting Policy*), *order on reh'g*, 113 FERC ¶ 61,173 (2005) (*Selective Discounting Policy Rehearing Order*)).

state that El Paso's cost of unsubscribed capacity is not an issue impacted by the Commission's *Selective Discounting Policy*.

364. With regard to the Initial Decision's discussion of the discount policy, UNS/Tucson Electric argue that the Presiding Judge impermissibly expands the discount adjustment into an entitlement. UNS/Tucson Electric do not believe that it is an entitlement. Citing the *Selective Discounting Policy*, UNS/Tucson Electric note that the Commission stated that "[a] discount adjustment is not an entitlement and the pipelines would be ill-advised to consider it so."[536] Further, they claim that the Commission assured captive customers "[i]t is possible to adopt measures to protect these customers in circumstances where the Commission's policy works an undue hardship on them and at the same time retain the competitive benefits of the [selective discounting] policy for the majority of shippers,"[537] and that the Commission "can take action to protect [captive] customers in case-specific situations."[538] UNS/Tucson Electric state that the Commission expanded upon a pipeline's burden of proof in the *Selective Discounting Policy Rehearing Order*: [539]

> [I]n individual rate cases, the parties are free to develop a record based on the specific circumstances on the pipeline to determine whether the discounts given were beneficial to captive customers. The pipeline has the burden of proof under [s]ection 4 of the NGA in a rate case to show that its proposal is just and reasonable. *If there are circumstances on a particular pipeline that may warrant special considerations or disallowance of a full discount adjustment, those issues may be addressed in individual proceedings.* Parties in a rate proceeding may address not only the issue of whether a discount was given to meet competition, but also issues concerning *whether the discount was a result of destructive competition and whether something less than a full discount adjustment may be appropriate in the circumstances.*

[536] UNS/Tucson Electric Brief on Exceptions at 13 (citing *Selective Discounting Policy*, 111 FERC ¶ 61,309 at P 24).

[537] *Id.* at 18 (citing *Selective Discounting Policy*, 111 FERC ¶ 61,309 at P 52).

[538] Citing *Selective Discounting Policy* at P 57.

[539] UNS/Tucson Electric Brief on Exceptions at 19 (citing *Selective Discounting Policy Rehearing Order,* 113 FERC ¶ 61,173 at P 22 (emphasis added, citation omitted)).

365. UNS/Tucson Electric assert that these Commission statements essentially place the burden of proof on a pipeline to demonstrate how its discounting proposal protects captive customers. UNS/Tucson Electric assert the Presiding Judge erred when he limited El Paso's burden to only demonstrating its discounts were required to meet competition.[540]

366. ACC/Southwest Gas state that the Presiding Judge's finding is based on two false assumptions: that a pipeline is entitled to a full discount adjustment as long as its discounts were given to meet competition and that a pipeline is entitled to full recovery of unsubscribed capacity costs.[541] ACC/Southwest Gas, citing the *Selective Discounting Policy Rehearing Order,* claim that parties may raise the issue of "whether something less than a full discount may be appropriate in the circumstances," and that it is then the pipeline's burden to support the level of discounts proposed.[542] If the Commission decides that ACC/Southwest Gas bears the section 5 burden to establish a risk sharing proposal, they argue they need only show that their risk sharing proposal is just and reasonable because El Paso has no existing practice of treating discount adjustments or unsubscribed capacity costs. ACC/Southwest Gas and UNS/Tucson Electric believe that El Paso has acknowledged that it has the burden of proof by filing rebuttal testimony on this issue.[543]

Briefs Opposing Exceptions

367. CPUC states the Initial Decision's discussion on the burden of proof is consistent with numerous relevant decisions.[544] CPUC contends that the key finding in the Initial Decision is that the discounts were made to meet competition; therefore the burden shifts to parties opposing the discount adjustment to show that it would be just and reasonable to deny El Paso's discount adjustment and impose their proposed remedy. CPUC notes that the parties opposing the full discount adjustment made no allegations that the discounts were illegal or that the discounts were not needed to meet competition.

[540] UNS/Tucson Electric Brief on Exceptions at 13.

[541] ACC/Southwest Gas Brief on Exceptions at 130; *see also* Municipal Customers Brief on Exceptions at 16.

[542] *Id.* at 131 (citing *Selective Discounting Policy Rehearing Order*, 113 FERC ¶ 61,173 at P 22).

[543] UNS/Tucson Electric Brief on Exceptions at 15 and ACC/Southwest Gas Brief on Exceptions at 130.

[544] CPUC Brief Opposing Exceptions at 9.

368. El Paso notes that no party disputed the Presiding Judge's finding that the discounts El Paso granted were required by competition. El Paso states that it did everything within its power to market its capacity, maximize its revenues, and thereby minimize the costs of unsubscribed capacity. El Paso argues there can be no dispute that all of its facilities were used and useful during the test period, and that even according to witnesses for parties advocating cost absorption, at most only a small fraction of its capacity (3 to 5 percent) was unsubscribed during the test period.[545] El Paso notes that the parties taking exception to the Presiding Judge's finding did not provide a single case where the Commission has denied a pipeline an opportunity to recover prudently-incurred costs, including costs related to discounting.

Commission Determination

369. The Commission has held that selective discounts generally benefit all customers, including customers that did not receive the discounts, because the discounts allow the pipeline to maximize throughput and thus spread its fixed costs across more units of service.[546] The Commission has further found that selective discounting protects captive customers from rate increases that would otherwise ultimately occur if pipelines lost volumes through the inability to respond to competition.

370. Further, since the 1989 Rate Design Policy Statement,[547] the Commission has held that if a pipeline grants a discount in order to meet competition, the pipeline is not required in its next rate case to design its rates based on the assumption that the discounted volumes would flow at the maximum rate, but may reduce the discounted volumes so that the pipeline will be able to recover its cost of service. The Commission explained that if a pipeline must assume that the previously discounted service will be priced at the maximum rate when it files a new rate case, there may be a disincentive to pipelines discounting their services in the future to capture marginal firm and interruptible business.

371. Consistent with the requirement in section 4(e) of the NGA that the pipeline bear the burden of proof to show that its proposed rate increase is just and reasonable, the Commission requires that pipelines always bear the ultimate burden of persuasion to show that any proposed discount adjustment is required by competition and just and reasonable. However, in the case of discounts given to non-affiliates, the Commission

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[545] El Paso Brief Opposing Exceptions at 92 (citing Ex. EPG-404 at 42).

[546] *Selective Discounting Policy*, 111 FERC ¶ 61,309 at P 3.

[547] *Interstate Natural Gas Pipeline Rate Design*, 47 FERC ¶ 61,295, *reh'g granted*, 48 FERC ¶ 61,122 (1989).

presumes that the discounts were required by competition, unless parties produce evidence raising reasonable questions as to whether competition required a particular discount.

372. As the Commission explained in the first *Selective Discounting Policy order*:

> Under the Commission's current policy, in order to obtain a discount adjustment in a rate case, the pipeline has the ultimate burden of showing that its discounts were required to meet competition. However, the Commission has distinguished between the burden of proof the pipeline must meet, depending upon whether a discount was given to a non-affiliate or an affiliate. In the case of discounts to non-affiliated shippers, the Commission has stated that it is a reasonable presumption that a pipeline will always seek the highest possible rate from such shippers, since it is in the pipeline's own economic interest to do so. Therefore, once the pipeline has explained generally that it gives discounts to non-affiliates to meet competition, parties opposing the discount adjustment have the burden of producing evidence that discounts to non-affiliates were not justified by competition. To the extent those parties raise reasonable questions concerning whether competition required the discounts given in particular non-affiliate transactions, then the burden shifts back to the pipeline to show that the questioned discounts were in fact required by competition.[548]

373. The Presiding Judge found, and no party took exception, that El Paso did make a showing that all of its discounts were required to meet competition, and that showing was not rebutted by the parties to the proceeding.[549]

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[548] *Selective Discounting Policy*, 111 FERC ¶ 61,309 at P 59.

[549] As stated in the quoted section of the *Selective Discounting Policy* above, the Commission is also concerned with discounts granted to affiliates. The Initial Decision did not address this issue. The Commission notes that in Exhibit G to El Paso's September 30, 2010 rate filing, El Paso did identify several discounted services provided on behalf of affiliates. As no party raised that issue on exceptions, the Commission presumes El Paso supported the appropriateness of its discounts to its affiliates in a satisfactory manner.

374. UNS/Tucson Electric and Texas Gas Service argue that on rehearing of the *Selective Discounting Policy*, the Commission clarified that, even when the pipeline satisfies its burden of showing that its discounts were required by competition, the pipeline has a further burden of showing that a full discount adjustment will not adversely affect captive customers in the particular circumstances on that pipeline. The rehearing order stated:

> [I]n individual rate cases, *the parties* are free to develop a record based on the specific circumstances on the pipeline to determine whether the discounts given were beneficial to captive customers. The pipeline has the burden of proof under Section 4 of the NGA in a rate case to show that its proposal is just and reasonable. If there are circumstances on a particular pipeline that may warrant special considerations or disallowance of a full discount adjustment, those issues may be addressed in individual proceedings. *Parties* in a rate proceeding may address not only the issue of whether a discount was given to meet competition, but also issues concerning whether the discount was a result of destructive competition and whether something less than a full discount adjustment may be appropriate in the circumstances.[550]

375. The Commission agrees that El Paso has the ultimate burden of persuasion to show that its proposed discount adjustment produces just and reasonable rates, based on all the circumstances on its system. However, as with the issue of whether the discounts were required by competition, it is also reasonable to place on the opponents of the discount adjustment a burden of producing evidence to explain why circumstances on El Paso's system require a rejection of a full discount adjustment in the design of El Paso's per unit rates. Our general policy is to permit a pipeline to design its rates so that it can recover 100 percent of its cost of service, if current market conditions continue. Therefore, opponents of a discount adjustment must produce evidence in an individual case to show special circumstances justifying a departure from that policy, before the burden shifts back to El Paso to show that its proposed discount adjustment is just and reasonable, despite the alleged special circumstances on its system.

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[550] *Selective Discounting Policy Rehearing Order,* 113 FERC ¶ 61,173 at P 22 (emphasis added).

B. <u>Treatment of the cost of unsubscribed and discounted capacity (Stipulated Issue VIII.B/C)</u>

<u>Initial Decision</u>

376. The Presiding Judge found that El Paso is entitled to the full discount adjustment. The Presiding Judge began its analysis by noting that a regulated entity is not *guaranteed* full recovery of its prudent costs or investment.[551] But the Presiding Judge recognized that a regulated entity cannot be denied a *reasonable opportunity* to fully recover its prudent costs.[552]

377. On the issue of unsubscribed capacity, the Presiding Judge recognized that many of El Paso's firm capacity contracts provide for variable monthly or seasonal demands that, coupled with El Paso's other competitive circumstances, resulted in approximately 50 percent of the pipeline's total long-term firm capacity being subscribed on something less than an annual basis. The Presiding Judge found that El Paso aggressively markets this relatively unattractive, short-term firm capacity to maximize revenues and billing determinants.[553] The result, the Presiding Judge found, is only two to five percent of El Paso's total sustainable capacity legitimately may be characterized as "unsubscribed." The Presiding Judge concluded that El Paso's unsubscribed capacity does not materially contribute to the protested rate increases.

378. With regard to the issue of discount adjustments, the Presiding Judge noted that it already found that El Paso must demonstrate its discounts were required to meet competition in order to receive a discount adjustment in this rate case. With regard to whether El Paso should be required to absorb the risk for a portion of the cost of its capacity discounts, the Presiding Judge noted that no party argued that El Paso's discount adjustment was not attributable to competition and that El Paso did not make every effort to market all of its capacity at the highest possible rates.[554] Therefore, the Presiding Judge found that El Paso is entitled to the full discount adjustment.

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[551] *Id.* P 263 (citing *FPC v. Hope Natural Gas*, 320 U.S. 591 (1944) (*Hope*); *Bluefield Water Works and Improvement Co. v. PSC*, 262 U.S. 679 (1923)).

[552] *Id. Accord El Paso Natural Gas Co.*, 90 FERC ¶ 61,050, at 61,216 (2000); *El Paso Natural Gas Co.*, 88 FERC ¶ 61,139, at 61,407 (1999) (citing *Hope*).

[553] Ex. EPG-183 at 39-42; Ex. EPG-324 at 17; Ex. EPG-340; *accord* Tr. 3093.

[554] ID at PP 267, 270 (citing Ex. EPG-177 at 21-29; Ex. EPG-404 at 36-46; Tr. 3219-20, 3408, 4027, 4075; Ex. IS-1 at 23; Ex. IS-7; Ex. SWG-1 at 46; Ex. EPG-310 at 22-23).

379. The Presiding Judge then addressed the protestors' alternative proposals. The Presiding Judge summarized the protestors' arguments as follows: El Paso's competitive situation has become so dire that the resulting reduction in billing determinants and compulsory capacity discounting will impose unjust, unreasonable or unduly discriminatory costs and rates on captive or recourse rate shippers unless the discount adjustment is disallowed in significant degree. The proposed special protections include the following: (a) offsetting the discount adjustment for each rate zone by the zone's discount percentage; (b) incentivizing El Paso to "right-size" its system to satisfy current and reasonably anticipated demand by imposing 87 percent of the discount adjustment on the pipeline; (c) requiring El Paso to absorb 75 percent of its indicated unsubscribed capacity costs in each rate zone and a percentage of the discount adjustment for each zone equivalent to the zonal discount percentages; (d) requiring El Paso to absorb 65 percent of the unsubscribed/discounted capacity costs; and (e) requiring El Paso to absorb 50 percent of the indicated discount adjustment attributable to long-term FT billing determinants in the rate design process, but any other cost-sharing proposal in the alternative. The Presiding Judge found that none of these proposals were just and reasonable, as none provided El Paso with an opportunity to recover its costs.

380. The Presiding Judge chiefly addressed Issue B (risk of unsubscribed capacity) and stated that his findings with regard to Issue B also resolved Issues C through F and I through L, mentioned above.

Briefs on Exceptions

381. UNS/Tucson Electric argue that they have demonstrated that special circumstances exist on El Paso's system that warrant the disallowance of the full discount adjustment due to the unjust, unreasonable and inequitable results it will have on captive shippers.[555] ACC/Southwest Gas argue that the principles of economic efficiency require risk sharing because in this case a situation exists where rates exceed cost-based levels, and shift large fixed-cost dollars from shippers with competitive pipeline alternatives to those with few or no such alternatives, thereby pressing the upper bounds of any just and reasonable rate level. ACC/Southwest Gas contend that the Presiding Judge did not appropriately address these issues.[556]

382. El Paso Electric argues that the Commission has made clear that it has the obligation to assure that rates to all customers are just and reasonable and mitigating

[555] UNS/Tucson Electric Brief on Exceptions at 15, 23.

[556] ACC/Southwest Gas Brief on Exceptions at 86-88.

measures may be considered when the rate impact on captive customers is inequitable.[557] El Paso Electric argues that as early as 1995 the Commission cautioned El Paso that it could not expect maximum rate customers to pay for all unrecovered costs of the pipeline.[558] Salt River argues that the captive shippers have provided evidence pointing to a developing crisis on the El Paso system that, left unchecked, will saddle captive shippers with the responsibility for contributing to El Paso's fixed costs at an unacceptable level, with no incentive for El Paso to rectify the situation.[559]

383. El Paso Electric claims that the Presiding Judge erroneously determined that protections for captive customers would deny El Paso a reasonable opportunity to recover all of its prudent costs in violation of the Fifth Amendment and the holding in the

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[557] El Paso Electric Brief on Exceptions at 52. *See also* ACC/Southwest Gas Brief on Exceptions at 41, Municipal Customers Brief on Exceptions at 5, Salt River Brief on Exceptions at 11 and UNS/Tucson Electric Brief on Exceptions at 18, who made similar arguments.

[558] *Id.* at 50 (citing *El Paso Natural Gas Co.*, 72 FERC ¶ 61,083, at 61,441 (1995) (*1995 Suspension Order*)). The issue in the cited proceeding was whether El Paso could unilaterally impose an exit fee. The Commission rejects the notion, suggested in El Paso Electric's argument, that a policy for imposition of a unilateral exit fee has been opened for discussion because of the Commission's electric policy. The exit fee mechanism proposed in the Commission's Electric NOPR is part of the Commission's comprehensive restructuring of the wholesale electric market and is intended to deal with the stranded costs that are expected to result from the transition to wholesale competition. *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, FERC Stats. & Regs. ¶ 31,036 (1996). In Order No. 636, the Commission set out its comprehensive rule for the restructuring of interstate pipeline services and the Commission included in that rule provisions for the recovery of transition costs. Order No. 636, FERC Stats. & Regs. ¶ 30,939 at 30,662. In the restructuring rule, the Commission recognized that exit fees could be negotiated with customers releasing capacity before the end of their contract term, or for the recovery of gas supply costs, but the Commission emphatically rejected the notion that a pipeline could unilaterally impose an exit fee. Order No. 636-B, 61 FERC at 62,041 & n.228. In the cases following Order No. 636, the Commission has consistently rejected pipeline attempts to unilaterally impose exit fees. *E.g.*, *1995 Suspension Order*, 72 FERC ¶ 61,083.

[559] Salt River Brief on Exceptions at 18; *see also* Municipal Customers Brief on Exceptions at 9-10.

Supreme Court's *Hope* case.[560] El Paso Electric urges the Commission to correctly apply the *Hope* case, which holds that NGA ratemaking involves a balancing of investor and consumer interests to protect customers against exploitation at the hands of natural gas companies.[561] El Paso Electric further claims that the Presiding Judge incorrectly applies the Supreme Court's *Hope* decision in regard to the Fifth Amendment, noting that the balancing of investor and customer interests recognized in the *Hope* decision validates the constitutionality of Congressional NGA authority.[562] Salt River contends that the Presiding Judge failed to acknowledge that standards under the NGA coincide with the constitutional standards of *Hope* and other precedent and that as a result, the Presiding Judge's blanket characterization of "cost-sharing" measures as unconstitutional is contrary to the Commission's mandate and the precedent supporting that mandate.[563] El Paso Electric argues that a limit on the proposed discount adjustment is appropriate and that the Commission should correct this error in the Initial Decision.[564]

384. Many participants contend the Presiding Judge erred in determining that alternative solutions to sharing the costs associated with the unsubscribed and discounted capacity on El Paso were not just and reasonable.[565] ACC/Southwest Gas disagree with the Presiding Judge's conclusion that risk-sharing advocates provided no quantitative comparison of rate impacts with shippers on other interstate pipelines. ACC/Southwest Gas state that every pipeline has different cost levels and different discount adjustments and therefore the Presiding Judge wrongly stated that a benchmark or range of impacts drawn from other pipelines is necessary.[566] ACC/Southwest Gas argue that Southwest

[560] El Paso Electric Brief on Exceptions at 8 (citing *Hope*, 320 U.S. 591); *see also* ACC/Southwest Gas Brief on Exceptions at 58.

[561] *Id.* at 13. *See also* ACC/Southwest Gas Brief on Exceptions at 62 and Salt River Brief on Exceptions at 13 (making similar arguments).

[562] *Id.* at 13.

[563] Salt River Brief on Exceptions at 13.

[564] El Paso Electric Brief on Exceptions at 9-10.

[565] ACC/Southwest Gas Brief on Exceptions at 63-64, 117-129; El Paso Electric Brief on Exceptions at 9-11; Municipal Customers Brief on Exceptions at 4-16; Indicated Shippers Brief on Exceptions at 21-25; Salt River Brief on Exceptions at 10-28; UNS/Tucson Electric Brief on Exceptions at 15-24; Golden Spread Brief Adopting Exceptions.

[566] ACC/Southwest Gas Brief on Exceptions at 82.

Gas' "risk-sharing" proposal offers the benefits of recognizing the relationship between unsubscribed and discounted capacity and provides a formulaic approach, which the Commission could use even if the Commission decided to change one of the variables.[567]

Briefs Opposing Exceptions

385. El Paso asserts that advocates of risk sharing err in their claims that the Presiding Judge failed to apply the correct legal standard in rejecting their proposals. El Paso argues that proponents of "risk sharing" have misstated and misapplied the legal principles established by *Hope, Bluefield,* and their progeny. El Paso contends that these precedents establish that a FERC-regulated pipeline must be given a reasonable opportunity to recover all of its prudently-incurred costs. El Paso argues that requiring it to absorb or share any portion of its prudently-incurred costs associated with unsubscribed capacity would, by definition, deny El Paso this opportunity.[568]

386. El Paso notes that proponents either misstate or ignore important precedent. El Paso states that the Supreme Court held that FERC's predecessor, the Federal Power Commission (FPC), was required to follow certain guidelines in setting a pipeline's rates. El Paso contends many "risk sharing" proponents gloss over the Court's other holding that "[f]rom the investor standpoint or company point of view it is important that there be enough revenue *not only for operating expenses but also for the capital costs of the business.*"[569] El Paso asserts that the advocates of cost absorption simply ignore many

[567] ACC/Southwest Gas Brief on Exceptions at 117. Salt River similarly argues its approach for calculating a discount adjustment is reasonable and by calculating the adjustment based on their method the Commission will create appropriate financial incentives for El Paso. Salt River Brief on Exceptions at 22. UNS/Tucson Electric recommend a limitation on the discount adjustment similar to the one agreed on in the 1996 El Paso Settlement. UNS/Tucson Electric Brief on Exceptions at 23-24. Indicated Shippers argue that El Paso should be required to absorb 50 percent of the discount adjustment related to long-term firm services. Indicated Shippers Brief on Exceptions at 21. Trial Staff argues that its proposal to impute billing determinants is a risk sharing proposal that would provide appropriate incentives to El Paso, protect customers and allow El Paso an opportunity to recover its costs. Trial Staff Brief on Exceptions at 149-150.

[568] El Paso Brief Opposing Exceptions 93-94.

[569] El Paso Brief Opposing Exceptions at 94 (referencing *Hope*, 320 U.S. 591 at 603) (emphasis added by El Paso). Additionally, CPUC makes the same argument in regards to various parties "misconstruing the Initial Decisions references to *Hope* and *Bluefield*." Brief Opposing Exceptions at 20.

other Commission orders and court opinions which faithfully apply this bedrock cost recovery principle.[570]

387. El Paso contends that Southwest Gas errs in its representation of the precedent established in *Assoc. Gas Distrib. v. FERC*.[571] El Paso argues that Southwest Gas is not asking the Commission to create *market conditions* that would indirectly prevent El Paso from passing through to its customers' prudently-incurred costs. Rather, El Paso asserts, Southwest Gas and other cost absorption proponents ask the Commission directly to require El Paso to absorb costs "by decree."[572] El Paso emphasizes that the Commission held in Order No. 636-C that "if the Commission did not permit pipelines to seek recovery of the full amount of their [gas supply realignment] costs through the mechanism provided by Order No. 636, the Commission would be denying recovery by regulatory decree, not simply allowing market forces to prevent full recovery."[573] El Paso states, substantial "risk sharing" already exists between El Paso and its ratepayers, asserting that the Presiding Judge struck the correct balance by rejecting the additional "risk sharing" proposals because they are simply punitive.[574]

388. El Paso argues that the Commission should uphold the Presiding Judge's finding allowing it a full discount adjustment.[575] El Paso asserts several advocates of "risk sharing" erroneously object to the Presiding Judge's ruling on the discount adjustment based on their interpretation of the Commission's 2005 *Selective Discounting Policy* orders. El Paso states that these parties contend the *Selective Discounting Policy* permits

[570] El Paso Brief Opposing Exceptions at 95-96 (citing Commission orders: *Portland Natural Gas Transmission System*, Opinion No. 510, 134 FERC ¶ 61,129, at P 362 (2011); *El Paso Natural Gas Co.*, 90 FERC ¶ 61,050, at 61,216 (2000); *Matagorda Offshore Pipeline System*, 135 FERC ¶ 61,048, at P 41 (2011); *Northern Natural Gas Co.*, 135 FERC ¶ 61,085, at P 18 (2011); *Williston IV*, 107 FERC ¶ 61,164 at P 90; *Tennessee Gas Pipeline Co.*, 80 FERC ¶ 61,070, at 61,200 (1997)).

[571] *Id.* at 98 (citing *Assoc. Gas Distrib. v. FERC*, 824 F.2d 981, 1012 (D.C. Cir. 1987) (characterizing as a "dubious procedure" treating a pipeline's discounted throughput as though the volumes were transported at the pipeline's maximum rate)).

[572] *Id.* at 104-105.

[573] *Id.* at 107 (citing Order No. 636-C, 78 FERC at 61,788).

[574] *Id.* at 109.

[575] *Id.* at 125. *See also* CPUC Brief Opposing Exceptions at 10; Edison Brief Opposing Exceptions at 64; SoCal Gas/San Diego Brief on Exceptions at 51-55.

captive shippers to argue that a full adjustment should be denied if special circumstances exist in a particular rate case. However, El Paso notes, the parties also admit the Commission has not explained what types of circumstances, if any, might qualify. El Paso argues that none of these parties submitted evidence that El Paso has more discounted transactions than other interstate pipelines. As such, El Paso asserts, there is no evidence that this case presents "special circumstances."[576]

Commission Determination

389. As discussed above, the Commission affirms the Presiding Judge's finding that El Paso had the NGA section 4 burden of proof with regard to its proposed methods of addressing discounting and unsubscribed capacity. Further, the Presiding Judge found that El Paso had provided adequate support for its proposals under section 4 of the NGA. Because the proposal is adequately supported, it is to be accepted as the just and reasonable rate. Issues B and C are whether El Paso should be required to absorb or bear the risk for a portion of the cost of unsubscribed capacity and the cost of discounts. Several parties argued in the proceeding that El Paso's proposals were not just and reasonable, and they proposed alternative methods to reflect the costs of unsubscribed capacity and discounts. The Initial Decision found that El Paso is entitled to a full discount adjustment and recovery of costs related to unsubscribed capacity and that it is inappropriate to require El Paso to absorb or bear the risk of those costs. The Commission affirms the Initial Decision.

390. No participant argues El Paso's discounts and unsubscribed capacity are not attributable to competition, and the record is overwhelming and unequivocal that they are.[577] Thus, El Paso has satisfied the burden of proof the Commission ordinarily requires pipelines to meet in order to show that a full discount adjustment to rate design billing determinants is just and reasonable. UNS/Tucson Electric, El Paso Electric, Municipal Customers, Salt River, UNS/Tucson Electric, and Indicated Shippers argue that, contrary to the Presiding Judge's findings, El Paso's proposed discount adjustment nevertheless results in rates that are not just and reasonable, but are exorbitant and fall disproportionately on captive customers. These parties argue the Commission's *Selective Discounting Policy Rehearing Order* imposed limits to protect captive customers from excessive and unjust rate increases caused by El Paso's significant and unreasonable level of discounting. They note that the Commission stated in the *Selective Discounting Policy* that it is possible to adopt measures to protect customers where the discount adjustment works an undue hardship on the customers, yet retain the competitive benefits for the majority of the shippers, and that the Commission would consider mitigating measures

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[576] El Paso Brief Opposing Exceptions at 125-126.

[577] ID, 139 FERC ¶ 63,020 at P 254.

where the rate impact on captive customers is inequitable on a case-by-case basis. They argue that they have shown that El Paso's maximum rates have significantly increased over the last several rate cases, as have the level of discounts that El Paso has given its customers. Consistent with the *Selective Discounting Policy* standards, these parties contend these facts demonstrate that El Paso's rates are too high.

391. The Commission rejects the parties' exceptions. The *Selective Discounting Policy* permits parties, on a case-by-case basis, to attempt to demonstrate that a discount adjustment works an undue hardship or is inequitable to the customers. However, as the Presiding Judge found,[578] a simple recitation that rates have gone up over the last few rate cases and that the main reason for the rate increases are the discounts El Paso has provided is not enough to show that the rates are unjust and unreasonable. El Paso contends that if customers were to look at the total of all the rate components for service instead of just the reservation rate component, decreases in El Paso's fuel rates alone have offset more than half of the increase in El Paso's transportation rates during the post-1996 period. El Paso claims that the gas cost savings on its system dwarf the increase in El Paso's reservation charges since 2008.[579] The Presiding Judge noted that the parties had no uniform basis of defining what the rate increases were, provided little context by which to evaluate the rate increases, and failed to consider the offsets to cost responsibility that discounting provided. The Presiding Judge found the claims that the rates were too high subjective judgments and insufficient to rebut the presumption that El Paso should receive the full discount adjustment.[580] The Presiding Judge found that El Paso did everything it could to remarket the capacity.

392. Moreover, earlier in this order, the Commission rejects El Paso's proposal to allocate costs among its rate zones based on discount-adjusted billing determinants, and requires El Paso to use unadjusted billing determinants for this purpose. El Paso Electric and other excepting parties take service in El Paso's East of California rate zones. As they point out, El Paso has provided most of its discounts to customers in its California rate zone, and El Paso's use of discount adjusted billing determinants to allocate costs has had the effect of shifting costs to the East of California rate zones. Our decision to

[578] *Id.* P 272.

[579] El Paso Brief Opposing Exceptions at 109-110 (citing Ex. EPG-404 at 51 (fuel rate decreases offset more than half of transportation rate increases since 1996); Ex. EPG-314 at 23-24 (base loading Line 1903 permits no compression to minimize fuel for all shippers); Ex. EPG-389 at 1 ($600 million and $1.2 billion per year of natural gas price savings for Arizona consumers)).

[580] ID, 139 FERC ¶ 63,020 at P 272.

require the use of unadjusted billing determinants for allocation purposes should mitigate this effect.

393. The Commission must balance the customer interest in protection from high rates against the investor interest in rates that produce a reasonable return. In the *Selective Discounting Policy* orders, the Commission found that a discount adjustment is appropriate where a discount is provided to meet competition. Discounts benefit all customers by allowing the pipeline to maximize throughput and thus spread fixed costs over a greater volume of sales, i.e., it is better to allow a discount so the pipeline maintains its throughput than to provide a disincentive to discounting which may lead a pipeline to lose customers. When a pipeline files its rate case after giving the discount, the pipeline is permitted to demonstrate that the discounts given in the test period were made to meet competition, and allowed to recover the discount in its rates. The NGA requires the Commission to approve rates that permit a pipeline an opportunity to recover 100 percent of its costs, and the Commission's discount policy provides the pipeline that is required to offer discounts to meet competition with the opportunity to propose a rate design that will permit it to do so. In this case, El Paso has met the criteria established in our *Selective Discounting Policy* orders. The Presiding Judge otherwise found the parties' objections to rates that are "too high" to be speculative and not supported by objective, comparative data. The Commission finds that the customers have failed to support their claim that rates would be too high inasmuch as El Paso has met the Commission's established criteria for a discount adjustment – criteria that reflect the fact that competition in the natural gas markets benefits all customers.

394. In sum, if El Paso had not aggressively marketed its unsubscribed capacity and met the competition, the implication of this record is that these service agreements – and the revenue that they generated – would not exist. If these discounted agreements did not exist, along with their related throughput and revenues, the proposed rates could have been even higher than what were proposed, as there would have been fewer agreements and throughput from which El Paso would have had an opportunity to recover its revenue requirement. The Commission finds, based on this record, that the opposing parties have not shown a basis to find that El Paso has not satisfied its burden of showing that the level of discounts to meet competition and its marketing of unsubscribed capacity were just and reasonable.

395. The Commission believes that the holding in the cost allocation section above, that El Paso may not reallocate fixed costs by using adjusted volumes in its discount adjustment that is inconsistent with its zonal cost allocation methodology, would address shippers' concerns with respect to improper reallocation of fixed costs as a result of the discount adjustment when El Paso implements the Commission's holding on compliance. Otherwise, the Commission finds no special circumstances to justify a departure from the *Selective Discounting Policy*.

396. Finally, the Commission affirms the Presiding Judge's rejection of the parties' alternative proposals. The courts have long recognized that there is no single just and reasonable rate, but instead that various rates may be just and reasonable.[581] The NGA gives the pipeline the primary initiative, through a section 4 filing, to propose its rates, terms, and conditions of service.[582] If the pipeline's proposal is just and reasonable, the Commission must accept it, regardless of whether other just and reasonable rates, terms, and conditions of service may exist.[583] Having affirmed the Presiding Judge's finding that El Paso's proposal is just and reasonable, the Commission need not consider whether the alternative proposals would also be just and reasonable.

C. Phase III of the Power-Up Project (Stipulated Issue VIII.G)

397. In 2002, El Paso proposed to install nine compressor facilities with 151,600 total horsepower at five existing South Mainline compressor stations, and at four new compressor stations in Arizona and Texas on Line 2000 of the South Mainline (Power-Up Project). The additional capacity would enable El Paso to transport gas from the eastern portion of its system to the southern and western portions, and was intended to enhance system flexibility. The Commission issued a certificate order authorizing the Power-Up Project's construction and operation on June 4, 2003.[584] El Paso then followed this construction sequence: (a) El Paso commenced Phase I construction July 16, 2003; (b) El Paso filed a notice of intent to proceed with Phase III on October 28, 2003; (c) El Paso commenced Phase II construction November 3, 2003; (d) El Paso commenced Phase III construction December 30, 2003; (e) El Paso placed Phase I into service February 27, 2004; (f) El Paso placed Phase II into service April 30, 2004; (g) El Paso placed Phase III into service June 11, 2004.[585] ACC/Southwest Gas argued that El Paso's decision to go forward with Phase III was imprudent or excessively risky in light of the

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[581] *Permian Basin Area Rate Cases*, 390 U.S. 747, 767 (1968); *Consolidated Edison*, 165 F.3d 992, 998, 1002-1004, *aff'g*, *Tennessee Gas Pipeline Co.*, Opinion No. 406-A, 80 FERC at 61,223-4. *See also Cities of Bethany*, 727 F.2d 1131,1138; *Alabama Electric Cooperative, Inc. v. FERC*, 684 F.2d 20, 2, (D.C. Cir. 1982).

[582] *Consolidated Edison*, 165 F.3d 992, 1002 (The NGA grants the "primary initiative for rate-setting to the pipeline").

[583] *Western Resources*, 9 F.3d 1568, 1578.

[584] *El Paso Natural Gas Co.*, 103 FERC ¶ 61,280 (*Power-Up Project Certification Order*), *order on reh'g*, 105 FERC ¶ 61,202 (2003) (*Power-Up Project Certification Rehearing*).

[585] ID, 139 FERC ¶ 63,020 at P 281.

p8ipeline's capacity situation at the time. ACC/Southwest Gas did not seek to remove the Phase III costs from El Paso's rate base or disallow its approximately $6 million in cost of service. Instead, ACC/Southwest sought to establish imprudence or excessive risk with respect to Phase III and that these are equitable factors that should be considered by the Commission in allocating unsubscribed and/or discounted capacity risk between El Paso and its shippers.

Initial Decision

398. The Presiding Judge found that ACC/Southwest Gas made no proposal to remove Phase III from El Paso's rate base or from its cost of service, and no other participants challenged the prudence of Phase III. The Presiding Judge concluded there was no issue to decide that was not otherwise addressed in Issue A above.

Briefs on Exceptions

399. ACC/Southwest Gas reiterate that El Paso's captive customers should not be held responsible for its "risky" business decisions, and contend that El Paso went forward with expansion projects knowing full well the competitive nature of the California market. ACC/Southwest Gas argue that El Paso's decision to proceed with Phase III of its Power-Up expansion was an imprudent decision and does not meet the Commission's prudence standards. ACC/Southwest Gas state that the Commission explicitly instructed El Paso to review its need for Phase III based on actual market demand after the in-service dates for Phases I and II, but that El Paso did not review actual market demand before proceeding. ACC/Southwest Gas state that when El Paso notified the Commission of its intent to construct and commenced construction of Phase III on October 28, 2003, El Paso had more than 150 MMcf/d of discounted contract demand in California. ACC/Southwest Gas state that El Paso's actions reveal a classic inefficient investment decision supported by moral hazard.[586]

400. ACC/Southwest Gas contend that if El Paso had waited until it had operating experience with Phases I and II, it would have known that the additional Phase III capacity was not needed even assuming that El Paso's firm contract demands after April 1, 2005 continued to include the 100 MMcf/d of demands previously served by El Paso in 2003.[587] Further, ACC/Southwest Gas contend, El Paso revealed that during 2003 El Paso knew that it could have relied on a portion of the capacity available from existing

[586] ACC/Southwest Gas Brief on Exceptions at 101-113.

[587] *Id.* at 116.

compressors to meet the 100 MMcf/d of short-term demands that it claims justified the Power-Up Phase III facilities.[588]

Briefs Opposing Exceptions

401. El Paso asserts the construction of Phase III was not only prudent but constructed at the request of most or all of its customers on the El Paso system, including Southwest Gas. El Paso further concludes that no party, including Southwest Gas, commented on El Paso's affirmation that Phase III was needed, or protested El Paso's Notice of Intent to proceed with its construction. El Paso suggests Southwest Gas omits the fact that many, if not all parties, believed at the time of the Notice of Intent for Phase III that demand for capacity on the El Paso system would continue to grow, both in California and East of California.[589]

402. El Paso additionally argues that Southwest Gas advances a completely new argument that was not addressed in its testimony: Phase III compressors were not needed because El Paso could have used existing compressors that it later sought to abandon. El Paso states if Southwest Gas' argument were to be considered at this late stage in the proceeding, El Paso would be deprived of due process. El Paso asserts all of the facts presented by Southwest Gas as to what El Paso should have known and considered prior to constructing Phase III are examples of hindsight that cannot form the basis for a finding of imprudence.[590]

Commission Determination

403. The Commission affirms the Presiding Judge on this issue. In the Power-Up proceeding, El Paso requested that the Commission make a predetermination that the costs of the Power-Up Project should be rolled-in with system rates. Southwest Gas supported that proposal.[591] The Commission granted El Paso's request, finding:

> [W]e are finding that the construction of the proposed facilities is justified because they are needed to meet existing customers' current needs. On that basis, we are finding that

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[588] *Id.* at 114.

[589] El Paso Brief Opposing Exceptions at 142-144.

[590] *Id.* at 147-148.

[591] *Power-Up Project Certification Order*, 103 FERC ¶ 61,280 at P 41.

> roll-in of the costs of the facilities is justified absent changed circumstances.[592]

404. This predetermination finding permitted El Paso to propose to roll-in the costs of the Power-Up project in its next NGA section 4 general rate case, which is the instant proceeding. El Paso did so. Thus, as the Initial Decision found with regard to Issue A, El Paso had a NGA section 4 proposal to include and roll-in the costs of the Power-Up Project, including Phase III, supported by the Commission's predetermination. ACC/Southwest Gas do not except to this finding.

405. ACC/Southwest Gas allege that El Paso went forward with expansion projects knowing the competitive nature of the California market. ACC/Southwest Gas argue that El Paso's decision to proceed with Phase III of its Power-Up expansion was an imprudent decision and does not meet the Commission's prudence standards. ACC/Southwest Gas state that the Commission explicitly instructed El Paso to review its need for Phase III based on actual market demand after the in-service dates for Phases I and II, but that El Paso did not review actual market demand before proceeding.

406. In the Power-Up proceeding, several parties questioned the need for the Power-Up Project. They argued that, before the Commission could determine whether the additional capacity on El Paso's system was needed, it must resolve the issue of how much capacity is currently available on El Paso's system.[593] The Commission disagreed and found:

> It is clear from the record in the Capacity Allocation Proceeding and from the routine *pro rata* cuts in the nominations of El Paso's firm customers, that El Paso does not have sufficient capacity at present to meet its existing customers' service requirements. In fact, in the recently completed allocation process, the Power-Up capacity was needed to ensure that the converting FR shippers would receive enough capacity to satisfy their requirements.[594]

407. On rehearing in the Power-Up proceeding, ACC alleged that the Commission improperly delegated to El Paso the authority to determine whether Phase III was

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[592] *Id.* P 43.

[593] *Id.* PP 30-32.

[594] *Id.* P 38; *see also* PP 33-40.

needed.[595] The Commission rejected the allegation, suggesting, contrary to the ACC/FR Shippers' and Texas Gas Service's claims, the Commission did not delegate its authority to El Paso to determine the need for Phase III of the Power-Up Project. The Commission's analysis of the need for the project did not distinguish the phases, but considered the need for the project as a whole based on the Commission's findings with respect to the amount of additional capacity El Paso's *existing shippers* required *to meet their existing needs.*[596]

408. ACC/Southwest Gas do not identify any Commission order that supports their contention that El Paso was required to evaluate the market before it proceeded with construction. ACC/Southwest Gas cannot make such a suggestion because the market was not a factor in the Power-Up Project. The Commission found in the Power-Up proceeding that the public convenience and necessity required that El Paso install the Power-Up compressors to meet the demand of *existing shippers to meet their existing needs*.[597] The Power-Up Project was proposed by El Paso for the purpose of meeting the demands of its then-existing firm shippers.[598] This project was not for the purpose of building speculative transportation capacity for an unknown market. The Commission found that the proposed compressors were required by the public convenience and necessity to create the transportation capacity to serve existing shippers' needs. El Paso

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[595] *Power-Up Project Certification Rehearing*, 105 FERC ¶ 61,202 at P 8.

[596] *Id.* P 12 (emphasis added).

[597] Indeed, in the *Power-Up Project Certification Order,* discussing the protests to the proposed Power-Up Project on the basis of a lack of market showing, the Commission stated:

> It is clear that the capacity at issue here is necessary to meet the needs of El Paso's current customers, eliminate the *pro rata* cuts in nominations, and restore reliable firm service on El Paso. [103 FERC ¶ 61,280 at P 38 (emphasis added).]

[598] In the Capacity Allocation Proceeding, both ACC and Southwest Gas argued that El Paso lacked sufficient capacity to meet core customers' needs. *Capacity Allocation Complaint Order,* 99 FERC at 62,025. Subsequently in that same proceeding, ACC argued that the capacity allocation problems on El Paso were caused by transient events. The Commission rejected ACC's arguments, finding that the arguments were undercut by their contemporaneous arguments that the full requirement customers would not receive sufficient capacity in the reallocation process adopted by the Commission. *Capacity Allocation Rehearing,* 104 FERC ¶ 61,045 at PP 50-52.

was not imprudent to install the compressors necessary to satisfy the requirements of its existing firm shippers. The Commission affirms the Presiding Judge on this issue.

409. The Commission has discussed the assessment of prudence, stating:

> Consistent with the cases discussed herein, we reiterate that managers of a utility have broad discretion in conducting their business affairs and in incurring costs necessary to provide services to their customers. In performing our duty to determine the prudence of specific costs, the appropriate test to be used is whether they are costs which a reasonable utility management (or that of another jurisdictional entity) would have made, in good faith, under the same circumstances, and at the relevant point in time. We note that while in hindsight it may be clear that a management decision was wrong, our task is to review the prudence of the utility's actions and the costs resulting therefrom based on the particular circumstances existing either at the time the challenged costs were actually incurred, or the time the utility became committed to incur those expenses.[599]

By that standard, El Paso's decision to invest in the Phase III compressors was made in good faith at the time.

D. Phase III of the Power-Up Project Estoppel Issues (Stipulated Issue VIII.H)

Initial Decision

410. The Presiding Judge found no reason why a participant would be collaterally or equitably estopped from challenging Phase III prudence. However, he also found that his findings on Stipulated Issue VIII.G principally resolved Stipulated Issue VIII.H. The Presiding Judge declined to evaluate whether prior settlements limited parties' rights under this issue.

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[599] *National Fuel Gas Supply Corp.*, 44 FERC ¶ 61,293, at 62,055 (1988) (quoting from *New England Power Co.*, 31 FERC ¶ 61,047, at 61,084 (1985), *aff'd,* 42 FERC ¶ 61,016, at 61,070 (1988), *reh'g denied,* 43 FERC ¶ 61,285 (1988)).

Brief on Exceptions

411. El Paso takes exception to the issuance of an advisory statement in the Initial Decision as well as the conclusion reached by the Presiding Judge. El Paso disagrees with the Presiding Judge's stating he saw "no reason why any participant would be estopped." El Paso argues the record indicates a number of reasons why all participants are estopped.[600]

412. El Paso believes that Southwest Gas should be barred from challenging the prudence of the Power-Up Project by the 2008 Rate Case Settlement and equitably and judicially estopped from taking a position that is inconsistent with its prior position in the Capacity Allocation Proceeding. El Paso states the Presiding Judge's statement concerning estoppels was inappropriate.[601]

Briefs Opposing Exceptions

413. ACC/Southwest Gas contend collateral estoppel only applies "where the issues presented have already been fully litigated and decided on the merits, and no new evidence or new circumstances would justify relitigation."[602] ACC/Southwest Gas assert the Commission should reject El Paso's estoppel arguments.

Commission Determination

414. The Commission affirms the Initial Decision's treatment of this issue, and finds no harm in the Presiding Judge's dicta. All parties, including El Paso, agreed, as part of their list of Stipulated Issues, to include Stipulated Issue VIII.G: Was El Paso's construction of Phase III of the Power-Up Project imprudent or excessively risky? Given this agreement, any party to the proceeding was free to make its case with regard to Stipulated Issue VIII.G. ACC/Southwest Gas presented their case, but El Paso prevailed. The Commission affirms the Presiding Judge, and need not reverse the Initial Decision on Stipulated Issue VIII.H; this is unnecessary and would not change the outcome for Phase III cost recovery.

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[600] El Paso Brief on Exceptions at 122.

[601] *Id.* at 126.

[602] ACC/Southwest Gas Brief Opposing Exceptions at 58 (citing *American Electric Power Service Corp. vs. Midwestern Independent Transmission System Operator, Inc.*, 122 FERC ¶ 61,083, at P 68, *reh'g denied*, 125 FERC ¶ 61,341 (2008)).

VIII. 1996 Settlement – Article 11.2 Issues – Stipulated Issues Section IX

Introduction

415. Article 11.2(a) of the 1996 Settlement provided that rates for service then under contract by eligible shippers would be capped, subject to inflation, and that the rate cap would continue to apply until the termination of shippers' transportation service agreements.[603] Article 11.2(b) provided that even if shippers with a contract covered by Article 11.2(a) entered into new service agreements in the future, their rates would not include costs attributable to capacity, up to the level in existence on the El Paso system at the time of the 1996 Settlement, that becomes unsubscribed or is subscribed at less than the Article 11.2 level.

416. The operation of Article 11.2 has been a highly contentious issue in numerous El Paso proceedings over the past ten years. In Opinion No. 517, after the issue was fully litigated, the Commission rejected arguments that Article 11.2 was no longer in the public interest and determined that the Article 11.2 rate caps remain in effect, notwithstanding changes to the El Paso system.[604] This finding is consistent with a series of orders over the last decade. In the Capacity Allocation Proceeding, the Commission rejected similar arguments that abrogation of Article 11.2 was required because the circumstances that made the 1996 Settlement just and reasonable no longer existed due to operational changes on the El Paso system.[605]

417. In the 2006 Rate Case, the Commission deferred consideration of El Paso's arguments that the changes ordered in the Capacity Allocation Proceeding terminated the Article 11.2 obligations under the 1996 Settlement.[606] In the *March 20 Order,* the Commission concluded that the Capacity Allocation Proceeding determined that the *Mobile-Sierra* public interest standard applied to any proposal to eliminate Article 11.2.[607]

[603] *See El Paso Natural Gas Co., L.L.C.*, 144 FERC ¶ 61,004 (2013).

[604] Opinion No. 517, 139 FERC ¶ 61,095 at PP 232-255; *Mobile Gas,* 350 U.S. 332; *Sierra,* 350 U.S. 348.

[605] *Capacity Allocation Rehearing,* 104 FERC ¶ 61,045 at PP 92-93.

[606] *March 20 Order,* 114 FERC ¶ 61,290 at PP 36-37.

[607] *March 20 Order,* 114 FERC ¶ 61,290 at P 34 (citing *Capacity Allocation Complaint Order,* 99 FERC at 62,005).

418. On rehearing of the *March 20 Order,* the Commission rejected El Paso's argument that the *Mobile-Sierra* doctrine should not apply. In the *September 5 Order,* the Commission stated that[608]

> [i]n the Capacity Allocation Proceeding, the Commission found that any changes to the 1996 Settlement must be justified under the *Mobile-Sierra* public interest standard, and the court upheld the Commission's decision. Therefore, [the] Commission's decision to apply *Mobile-Sierra* to changes to the 1996 Settlement is final and not subject to review here. Despite El Paso's contention, there is no justifiable reason to make an exception for changes to Article 11.2, while holding the rest of the 1996 Settlement to review under *Mobile-Sierra*.

419. In Opinion No. 517, the Commission extensively addressed Article 11.2 issues, including whether Article 11.2 produces just and reasonable rates, consistent with the public interest. Opinion No. 517 (1) affirmed the Presiding Judge's determination that the *Mobile-Sierra* standard applies and that Article 11.2 should not be abrogated under the *Mobile-Sierra* public interest standard; (2) affirmed the Presiding Judge's conclusion that El Paso may not reallocate to non-Article 11.2(a) shippers or contracts any shortfall arising as a result of Article 11.2(a) rates being lower than recourse rates; (3) found that El Paso had satisfied the Article 11.2(b) requirements; and (4) found that the subsidiary issue as to the Article 11.2(b) rights of shippers that acquire Article 11.2(a) contracts was moot because Article 11.2(b) was not triggered at that time.[609]

420. El Paso's September 30, 2010 revised tariff filing in the instant docket proposed two alternate sets of tariff records reflecting different facility cost allocations for contracts covered by Article 11.2 of the 1996 Settlement. A "primary" set of tariff records reflected rates for Article 11.2(a) contracts calculated in accordance with Article 11.2(a). An "alternate" set of tariff records reflected rates for Article 11.2(a) contracts which included costs attributable to certain El Paso expansion capacity constructed after 1995. The *2011 Rate Case Suspension Order* accepted the primary tariff records (subject to refund, hearing and the final outcomes of proceedings in the 2006 Rate Case, the 2008 Rate Case, and the Fuel Complaint Case), but expressly rejected the alternate tariff records. On rehearing, the Commission clarified that "Article 11.2 contract issues will be eligible for litigation in this case only to the extent that they are not finally decided in [the

[608] *September 5 Order,* 124 FERC ¶ 61,227 at P 41 (citing *ACC*, 397 F.3d 952).

[609] Opinion No. 517, 139 FERC ¶ 61,095 at PP 232-235, 289-300, 322-330, 331-332.

2008 Rate Case]" and that "the Commission's intent is to prevent re-litigation of identical issues in this rate case prior to a final determination on these Article 11.2 issues in the [2008 Rate Case] proceeding."[610] Accordingly, the Presiding Judge limited this proceeding to issues relating to El Paso's primary tariff records, and states that he made every effort, despite the contentious nature of the issue, to prevent re-litigating issues pending in the 2006 Rate Case, the 2008 Rate Case and the Fuel Complaint Case—particularly the 2008 Rate Case.[611]

421. The Stipulated Issues in this case include eight issues related to Article 11.2 which are discussed below, with the exception of Issue IX.B (whether El Paso's proposed tariff revision to apply a system average Article 11.2(a) usage rate to certain imbalances is just and reasonable). The Presiding Judge stated that this issue was not addressed at the hearing or in briefs and therefore no longer appears to be an issue in this proceeding. Because no exceptions were submitted on this issue, the Commission summarily affirms the Presiding Judge on this issue. The Commission discusses the remaining stipulated issues below, including IX.A (whether Article 11.2 is no longer in the public interest), IX.C (the Article 11.2(a) revenue shortfall), IX.D (the impact of rate design changes), IX.E (the bifurcated cost of service), IX.F/G (the Article 11.2(b) presumption), and IX.H (successor-in-interest eligibility under Article 11.2(b)).

A. Whether Changed Circumstances Render Article 11.2 No Longer in the Public Interest (Stipulated Issue IX.A)

422. El Paso, Competitive Power Suppliers, Edison, and SoCal Gas/San Diego argue that the record in this proceeding confirms new facts and circumstances that arose after the 2008 Rate Case test period, and consequently were not before the Commission there. Based on these new circumstances, and irrespective of Opinion No. 517, they argue the Commission should (1) terminate Article 11.2 prospectively under *Mobile-Sierra*; or (2) find the rates resulting from Article 11.2 are now unjust and unreasonable, and must be replaced by rates that fairly apportion the Post-1995 Facilities cost of service.[612]

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[610] *2011 Rate Case Suspension Rehearing,* 133 FERC ¶ 61,253 at PP 14, 16.

[611] ID, 139 FERC ¶ 63,020 at P 290 n.268.

[612] *See also* ID, 139 FERC ¶ 63,020 at P 292 n.269 (stating that the parties do not agree as to the applicable burden of proof on this issue, i.e., whether the just and reasonable or the public interest standard applies). The burden of proof applicable to changes to the Article 11.2 rates was addressed in the 2008 Rate Case and will not be relitigated here.

423. APS, Rate Protected Shippers, and Texas Gas Service take the position there are no new facts or circumstances here that should affect Article 11.2. They argue the only new "fact" El Paso or any other participant legitimately can cite in this case is an increase in the indicated rate differential between Article 11.2(a) and non-Article 11.2(a) service.

Initial Decision

424. The Presiding Judge found that this issue is largely, if not entirely, resolved in Opinion No. 517, which held that *Mobile-Sierra* is controlling insofar as Article 11.2 is concerned.[613] El Paso must therefore provide sufficient evidence that was not before the Commission in the 2008 Rate Case to establish that the contracts seriously harm the public interest. The Presiding Judge stated that this also applies to non-Article 11.2 shippers challenging the provision.[614] The Presiding Judge adopted the Commission's finding in Opinion No. 517 that opponents of Article 11.2 must demonstrate the requisite extraordinary circumstances sufficient to "impose excessive burdens on third parties, or be unduly discriminatory such that the public interest is seriously harmed" had not been demonstrated on the record before it.[615]

425. The Presiding Judge stated that El Paso has in three previous proceedings sought to abrogate Article 11.2 as inconsistent with the public interest, and the Commission has rejected El Paso's position each time, most recently in Opinion No. 517. El Paso's arguments here are its fourth attempt, claiming drastically different facts and circumstances support abrogation of Article 11.2. The Presiding Judge cited Opinion No. 517 at PP 240-241 where the Commission observes:

> Parties cite a host of changes that they claim justify revisiting the continued efficacy of Article 11.2(a). However, with the

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[613] ID, 139 FERC ¶ 63,020 at P 295 (citing Opinion No. 517, 139 FERC ¶ 61,095 at P 232).

[614] *Id.* (citing Opinion No. 517, 139 FERC ¶ 61,095 at P 234); *see also NRG Power Mktg., LLC v. Maine Pub. Utils. Comm'n*, 558 U.S. 165, 174-77 (2010) (*NRG*). The Presiding Judge noted that Competitive Power Suppliers' argument that the applicable non-party standard is whether the non-parties constitute shippers similarly situated to the settling parties but differently treated is not correct, and would not avail them if it were. Although Competitive Power Suppliers clearly are treated differently than Article 11.2 shippers, the Presiding Judge held that they are not similarly situated to them precisely because Article 11.2 shippers pay a *unique* rate by virtue of the 1996 Settlement. *See* Tr. 1157.

[615] *Id.* (citing Opinion No. 517, 139 FERC ¶ 61,095 at P 236).

> exception of the current rate differential between recourse rates and the Article 11.2(a) rate cap, and recent turnbacks, including those attributable to Article 11.2(a) shippers, the factors cited appear to have all been present in the Capacity Allocation Proceeding, where we did not find abrogation of Article 11.2(a) supported….Despite El Paso's claim that these arguments have not been heard before, they have.

426. The Presiding Judge further cited Opinion No. 517 on the issue of the expansion capacity:

> Moreover, the U.S. Court of Appeals for the D.C. Circuit has agreed that, rather than constructing the expansion capacity at the urging of its former full requirements customers or because those customers demanded it, El Paso was already obligated under its full requirements contracts to meet those customers' full requirements, and the Capacity Allocation Proceeding merely implemented a reasonable way to do so.[616]

427. The Presiding Judge stated that the preceding quotes confirm El Paso made every argument it makes here in the 2008 Rate Case. They also confirm the only arguments El Paso and supporting participants did not also make in previous proceedings addressed (i) the current rate differential between recourse rates and the Article 11.2(a) rate cap; and (ii) recent turnbacks—including those attributable to Article 11.2(a) shippers. The Presiding Judge concluded that the only new fact El Paso and supporting participants raise in the instant case is the increase in the Article 11.2/non-Article 11.2 rate differential. The Presiding Judge stated that the Article 11.2/non-Article 11.2 rate differential is almost exclusively attributable to El Paso's need to offer capacity discounts in response to competition—particularly in the California zone, where Article 11.2(a) is not a factor.[617] The Presiding Judge therefore found El Paso, Competitive Power Suppliers, Edison, and SoCal Gas/San Diego had failed to demonstrate the requisite

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[616] *Id.* P 297 (citing Opinion No. 517, 139 FERC ¶ 61,095 at P 244 as upheld in *Freeport*, 669 F.3d at 309).

[617] *Id.* P 297 n.272 ("As previously noted, [the] Discount Policy Statement also suggests the ratepayer benefits competition confers—specifically, captive/recourse rate shippers' eventual access to competitive options—are paramount to any higher short-term costs the discount adjustment may impose on captive/recourse rate shippers[,]" (citing *Selective Discounting Policy*, 111 FERC ¶ 61,309 at P 56); *Selective Discounting Rehearing Order*, 113 FERC ¶ 61,173 at P 115).

extraordinary circumstances, excessive third party burdens or undue discrimination required to modify or abrogate Article 11.2 under *Mobile-Sierra*.

Briefs on Exceptions

428. El Paso asserts that, because the Presiding Judge was specifically instructed by the Commission not to consider the Article 11.2 issues previously litigated in the 2008 Rate Case, the record does not provide a complete picture of the adverse impacts of Article 11.2. Thus, El Paso asserts that neither case alone encompasses the entire evidentiary record relevant to determining whether Article 11.2 remains in the public interest and that failure to consider these cases together substantially understates the cumulative adverse impacts arising from Article 11.2.[618] El Paso and Competitive Power Suppliers assert that the Presiding Judge largely failed to address the new facts presented in this case that were not addressed in Opinion No. 517.[619]

429. El Paso and Competitive Power Suppliers state that the Presiding Judge erred by not finding that Article 11.2 is against the public interest and/or produces unjust and unreasonable rates.[620] El Paso states that because the Commission has found that Article 11.2(a) rates only cover the costs of the 1995 system, Article 11.2 shippers avoid paying an equal share of responsibility for the Post-1995 Expansion costs they demanded, thus preferentially lowering their rates below those of other similarly-situated shippers, which is neither just nor reasonable.[621] The Competitive Power Suppliers argue that the Article 11.2 rates are so comparatively low that it is unjust and unreasonable, as well as unduly discriminatory. The Competitive Power Suppliers members point to the fact that they pay 56 percent more than Article 11.2 rates for the identical service.[622]

430. The Competitive Power Suppliers point out that under Rate Schedule FT-1, El Paso provides firm transportation service to both Article 11.2 Shippers and Competitive Power Suppliers members, where the quality, terms, and conditions of the

[618] El Paso Brief on Exceptions at 128-129.

[619] El Paso Brief on Exceptions at 128; Competitive Power Suppliers Brief on Exceptions at 4.

[620] El Paso Brief on Exceptions at 129; Competitive Power Suppliers Brief on Exceptions at 9. El Paso incorporates by reference its detailed request for rehearing of Opinion No. 517 on Article 11.2 issues.

[621] El Paso Brief on Exceptions at 130.

[622] Competitive Power Suppliers at 9.

FT-1 service are the same for all shippers, but not the rates; hence they believe it is unduly discriminatory to have different rates for the two groups of shippers. The Competitive Power Suppliers claim that the Presiding Judge mistakenly characterizes the Article 11.2 rate as the maximum recourse rate; however, recourse rates are cost-based rates that are available to all of a pipeline's customers.[623] The Competitive Power Suppliers argue that the Article 11.2(a) rates are not cost-based rates, as they are available only to the Article 11.2 Shippers and not available to all of El Paso's Rate Schedule FT-1 customers. The Competitive Power Suppliers argue that the Presiding Judge's holding that the Article 11.2(a) rates are a "unique category of maximum recourse rates" is a concept that has no basis in fact and is erroneous. The Competitive Power Suppliers ask the Commission to increase the Article 11.2(a) rates to accurately reflect the actual costs of the transportation facilities used to provide service to the Article 11.2 Shippers, or alternatively, to terminate Article 11.2.[624]

431. El Paso argues that Article 11.2(a) rate caps are not in the nature of a contract within the meaning of the *Mobile-Sierra* doctrine, but leave the Commission free to reject the proposed rates without having to meet the public interest standard. El Paso asserts that the Commission may and should (1) determine that Article 11.2(a) rates misallocate cost responsibility among El Paso's shippers, and (2) prescribe different just and reasonable rates for all shippers. The Competitive Power Suppliers also argue that the ordinary "just and reasonable" standard, rather than the "public interest" standard, should be used to determine whether Article 11.2 should be terminated. The Competitive Power Suppliers cite the cost-causation principle as the "touchstone in any legal analysis of FERC-approved rate schemes" that requires "that all approved rates reflect to some degree the costs actually caused by the customer who must pay them."[625] The Competitive Power Suppliers claim that Article 11.2(a) produces rates that are not based on the costs of El Paso's system today.

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[623] Competitive Power Suppliers Brief on Exceptions at 13 (citing *Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines*, 74 FERC ¶ 61,076 at 61,241, *reh'g denied*, 75 FERC ¶ 61,024 (1996)).

[624] Competitive Power Suppliers Brief on Exceptions at 13-15.

[625] Competitive Power Suppliers Brief on Exceptions at 11 (citing *K N Energy, Inc. v. FERC*, 968 F.2d 1295, 1300 (D.C. Cir. 1992); *Village of Bethany v. FERC*, 276 F.3d 934, 937 (7th Cir. 2002); *N. States Power Co.*, 64 FERC ¶ 61,324, at 63,379 (1993)).

432. Competitive Power Suppliers argue that contracts bind parties, not non-parties.[626] Although Competitive Power Suppliers acknowledge that the Supreme Court in *NRG* indicated that the "public interest" standard can apply to both contracting parties and non-contracting parties with regard to Commission-approved settlements, they argue that, unlike the challengers in *NRG*, Gila River and New Harquahala did not exist in 1996 and therefore could not have been involved in the proceeding that led to the 1996 Settlement.[627]

433. Competitive Power Suppliers and El Paso assert that the record demonstrates that the discriminatory rate differences produced by Article 11.2 became substantially more severe during the test period underlying the rates filed in this proceeding than in the 2008 Rate Case. El Paso states that the Presiding Judge erroneously concluded that this was the only new fact/circumstance in this case, and failed to recognize that the central cause of the increase was the turnback of capacity by Article 11.2 shippers themselves, many of which occurred after the close of the 2008 Rate Case test period. El Paso states that the amount of capacity turnbacks from Article 11.2 shippers now exceeds the combined 550 MMcf/d capacity of the Line 2000 and Power-Up expansion projects that these and El Paso's other shippers demanded.[628]

434. El Paso argues that another new fact is that, since 2008, the shippers who have turned back capacity to El Paso have taken similar capacity on the Transwestern Expansion which commenced in 2009. El Paso states that most of the capacity relinquished by these shippers was from non-Article 11.2 contracts. El Paso contends that it is not just and reasonable for Article 11.2 shippers who have shifted a portion of their needs to competing pipelines to continue to demand the benefits of Article 11.2 for their remaining El Paso service.[629]

435. El Paso states that Article 11.2 shippers are similarly situated with other shippers concerning responsibility for the costs of the post-1995 facilities. El Paso states that the Commission has found Article 11.2 was only intended to protect eligible contracts from the costs of unsubscribed and discounted 1995 capacity, and never was intended to protect Article 11.2 shippers from the costs of Post-1995 Expansion which they

[626] Competitive Power Suppliers Brief on Exceptions at 9-10 (citing *Maine Pub. Util. Comm'n. v. FERC*, 520 F.3d 464, 478 (D.C. Cir. 2008)).

[627] Competitive Power Suppliers Brief on Exceptions at 10 (citing *NRG*, 558 U.S. 165, 174-77).

[628] El Paso Brief on Exceptions at 131, 133-135.

[629] *Id.* at 135-136.

demanded. El Paso concludes that the Commission should reject the proposed Article 11.2(a) rates for the term of the effectiveness of this proceeding.[630]

Briefs Opposing Exceptions

436. Rate Protected Shippers/ACC argue that the Commission explicitly held that this proceeding would be subject to the decisions rendered in the 2008 Rate Case regarding the continued effectiveness of Article 11.2.[631] Rate Protected Shippers/ACC argue that El Paso recognized the only issue here involves changes in the impact of Article 11.2 since the 2008 Rate Case and not the facts and issues litigated in the 2008 Rate Case; the Joint Stipulation of the parties in this proceeding also reflected this understanding.[632] APS also suggests that El Paso is trying to improperly relitigate Article 11.2 issues beyond the scope of issues set for hearing in this case.[633]

437. Rate Protected Shippers/ACC, APS, Salt River, and Texas Gas Service argue that El Paso and Competitive Power Suppliers failed to establish that circumstances have changed sufficiently since the record was reviewed in the 2008 Rate Case to justify abrogating Article 11.2 as contrary to the public interest.[634] Rate Protected Shippers/ACC argue that Opinion No. 517 sets a very high bar, finding that El Paso must provide "convincingly detailed analysis sufficient to establish that Article 11.2 will impair the financial ability of El Paso to provide service, impose excessive burdens on third parties, or be unduly discriminatory such that the public interest is seriously harmed," in order to abrogate or modify Article 11.2 under the *Mobile-Sierra* standard.[635]

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[630] *Id.* at 136-137.

[631] Rate Protected Shippers/ACC Brief Opposing Exceptions at 4-5 (citing *2011 Rate Case Suspension Rehearing*, 133 FERC ¶ 61,253 at P 16).

[632] Rate Protected Shippers/ACC Brief Opposing Exceptions at 5 (citing El Paso Brief on Exceptions at 126-127 & n.15; Joint Stipulation at 18).

[633] APS Brief Opposing Exceptions at 29-30.

[634] Rate Protected Shippers/ACC Brief Opposing Exceptions at 7; APS Brief Opposing Exceptions at 31; Salt River Brief Opposing Exceptions at 9; Texas Gas Service Brief Opposing Exceptions at 16.

[635] Rate Protected Shippers/ACC Brief Opposing Exceptions at 7 n.26 (citing Opinion No. 517, 139 FERC ¶ 61,095 at P 236).

438. Rate Protected Shippers/ACC and Texas Gas Service argue that the Presiding Judge fully evaluated the difference between Article 11.2(a) rates and the proposed recourse rates and accurately determined that this difference did not constitute a change in circumstances amounting to such serious harm to the public interest as would justify abrogating Article 11.2 under the *Mobile-Sierra* standard.[636]

439. Rate Protected Shippers/ACC contend that this rate disparity cannot create excessive third party burdens or be unduly discriminatory when El Paso discounts its maximum recourse rates by like (and even greater) amounts.[637] Rate Protected Shippers/ACC state that the average rate paid by El Paso's discounted shippers is 61 percent of the as-filed recourse rate, a greater difference than with Article 11.2(a) rates.[638]

440. Rate Protected Shippers/ACC state that the courts and the Commission recognize it is "not sufficient to justify contract modification under *Mobile-Sierra* that some shippers pay a different rate under a contract or settlement than other shippers on the system."[639] Rate Protected Shippers/ACC argue that El Paso and Competitive Power Suppliers must show that the resulting rate is unduly discriminatory or causes an excessive burden, which they failed to establish.

441. Texas Gas Service cites Opinion Nos. 507 and 507-A to support its argument that shippers that did not enter into the 1996 Settlement did not shoulder the burdens and

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[636] Rate Protected Shippers/ACC Brief Opposing Exceptions at 8 (citing ID, 139 FERC ¶ 63,020 at P 297); Texas Gas Service Brief Opposing Exceptions at 8, 16; APS Brief Opposing Exceptions at 33; *see also* Rate Protected Shippers/ACC Brief Opposing Exceptions at 9 (citing Rate Protected Shippers Reply Br. 6-9 (explaining that the actual difference between El Paso's proposed monthly maximum FT-1 reservation rate for Arizona and its Article 11.2(a) rate for 2012 was only 36 percent)).

[637] Rate Protected Shippers/ACC Brief Opposing Exceptions at 10 (citing *March 20 Order*, 114 FERC ¶ 61,290 at P 35; *September 5 Order*, 124 FERC ¶ 61,227 (2008), *aff'd Freeport-McMoRan*, 669 F.3d 302 (D.C. Cir. 2012), which cites *Potomac Elec. Power Co. v. FERC*, 210 F.3d 403 (D.C. Cir. 2000); *Cities of Bethany*, 727 F.2d 1131, 1193; *United Municipal Distributors Group v. FERC*, 732 F.2d 202 (D.C. Cir. 1984)).

[638] Rate Protected Shippers Reply Br. 8-9 (citing Ex. SRP-1 at 13:22).

[639] Rate Protected Shippers/ACC Brief Opposing Exceptions at 10.

would not be considered similarly situated to shippers that did enter into the 1996 Settlement.[640]

442. Rate Protected Shippers/ACC and Salt River argue that El Paso's focus on capacity turnbacks by certain shippers with Article 11.2(a) contracts is not a "new fact" either; in Opinion No. 517, the Commission addressed El Paso's arguments regarding capacity turnbacks, including those attributed to Article 11.2(a) shippers, and rejected them, holding that "[d]espite El Paso's claim that these arguments have not been heard before, they have."[641] Rate Protected Shippers/ACC argue that if this rate disparity is not contrary to the public interest in and of itself, then the reasons for the rate disparity are not germane.[642]

443. Rate Protected Shippers/ACC, APS, and Texas Gas Service argue that the record is clear that the enormous increase in discounting and unsubscribed capacity in California is the fundamental cause of the increase in El Paso's rates.[643] Rate Protected Shippers/ACC argue that El Paso overstates the economic effect of certain Article 11.2 shippers' exercising their contractual rights not to extend their service since the record in the 2008 Rate Case closed in 2008. Rate Protected Shippers/ACC argue that El Paso omits the fact that shippers that turned back FT-1 capacity added new premium services at rates higher than FT-1 service to replace much of their turned-back capacity.[644]

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[640] Texas Gas Service Brief Opposing Exceptions at 16 (citing *Transcon. Gas Pipe Line Corp.*, Opinion No. 507, 130 FERC ¶ 61,043, at P 2 n.4 (2010); *Transcon. Gas Pipe Line Corp.*, 53 FPC 628 (1975); *Transcon. Gas Pipe Line Corp.*, Opinion No. 507-A, 139 FERC ¶ 61,002, at P 43 (2012)).

[641] Rate Protected Shippers/ACC Brief Opposing Exceptions at 11 (citing Opinion No. 517, 139 FERC ¶ 61,095 at P 241); Salt River Brief Opposing Exceptions at 9.

[642] Rate Protected Shippers/ACC Brief Opposing Exceptions at 11.

[643] Rate Protected Shippers/ACC Brief Opposing Exceptions at 12 (citing Ex. SWG-1 at 104:12-105:4, documenting$124 million of both unsubscribed and discounted capacity costs in this rate proceeding; ID, 139 FERC ¶ 63,020 at P 297); APS Brief Opposing Exceptions at 33; Texas Gas Service Brief Opposing Exceptions at 8.

[644] Rate Protected Shippers/ACC Brief Opposing Exceptions at 12 and n.51 (citing Ex. UNS-1 at 9:22–23; Ex. UNS-5; Opinion No. 517 at P 328: "The Initial Decision also erred in not counting CRNs associated with El Paso's premium hourly services, in part because the capacity used to provide the hourly flexibility in the FTH services is not included in a billing determinant, but also because the Presiding Judge determined that CRNs were not subscribed.").

444. Rate Protected Shippers/ACC argue that El Paso again failed to make a coherent argument that turnbacks by Article 11.2 shippers are the central cause of the increase in the difference between Article 11.2(a) and recourse rates.[645] Salt River argues that base rates alone do not reflect the entire financial impact that must be assessed when considering alternative pipeline services, like those offered by Transwestern. Salt River argues that El Paso has not offered discounts to Arizona shippers to retain their service, which is evidence that despite its rhetoric El Paso does not judge the services it provides East of California shippers to be at risk.[646]

445. Rate Protected Shippers/ACC argue that turnbacks by California shippers are more significant than turnbacks by Article 11.2 shippers, and there is no nexus between Article 11.2 shippers and El Paso's underutilized expansion projects which were designed, in significant part, to supply customers in California.[647]

446. APS observes that El Paso does not even mention the reduction in contracted capacity or the deeper discounting in California as reasons for the increase to the differential between Article 11.2(s) rate caps and recourse rates.[648] APS notes that El Paso's Witness Palazzari testified that the reason for the larger impact of Article 11.2(a) in this case is primarily due to the upward pressure stemming from the decline in billing determinants and that such decline is caused by the intense competition El Paso faces in California.[649] APS observes that the amount of turnback capacity from Article 11.2(a) shippers is less than the reduction of California capacity, and that 70 percent of the capacity turnbacks in Arizona are related to FTH premium services, which rates El Paso has proposed to increase by 56 percent in this proceeding.[650]

447. Salt River states that El Paso's allegations associated with East of California shipper turnbacks are misleading, in that the record shows that while East of California

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[645] Rate Protected Shippers/ACC Brief Opposing Exceptions at 13.

[646] Salt River Brief Opposing Exceptions at 4-6.

[647] Rate Protected Shippers/ACC Brief Opposing Exceptions at 13.

[648] APS Brief Opposing Exceptions at 34 (citing Ex. EPG-401 at column (c), Line 6 compared to Ex. APS-12, column (c), Line 6; Exs. APS-1 at 35:12-29, APS-8 at lines 3 and 6).

[649] *Id.* at 34 (citing Ex. EPG-211 at 10-11).

[650] *Id.* at 35 (citing El Paso Brief on Exceptions at 134, Ex. EPG-401 (sum of lines 13, 18, 23 and 29), Ex. APS-12 (sum of lines 13, 18, 23, 29), El Paso Initial Br. 169).

shippers have subscribed approximately 256,000 Dth more capacity between 2005 and 2010, California shippers turned back approximately 620,000 Dth/d during the same time period.[651]

448. APS and Salt River reject El Paso's attempt to inject Transwestern as a new circumstance.[652] Salt River argues that contrary to El Paso's claims, Arizona shippers' purchase of service on Transwestern and turn back of capacity to El Paso was raised by El Paso and supporting participants in the 2008 Rate Case, factored into that initial decision, addressed in El Paso's brief on exceptions, and considered and rejected as justifying abrogation of Article 11.2 in Opinion No. 517. Salt River states that the fact that the in-service date of the Transwestern Expansion occurred in 2009, after the end of the 2008 Rate Case test period, is a meaningless distinction that should be disregarded.[653]

Commission Determination

449. The Commission affirms the Presiding Judge's finding that the asserted changed circumstances do not support a determination that Article 11.2 rates are not in the public interest or are unjust and unreasonable, or unduly discriminatory. In Opinion No. 517, the Commission affirmed its prior determinations that the *Mobile-Sierra* public interest standard applies in determining whether the Article 11.2 rates remain in effect, are just and reasonable, and should not be eliminated in light of changes to the El Paso system. In setting this case for hearing, the Commission stated that Article 11.2 issues that were litigated in the 2008 Rate Case were not to be relitigated here and conditioned acceptance of the primary tariff records on the outcome of the hearing in the 2008 Rate Case relating to Article 11.2.[654] Because the Commission held in Opinion No. 517 that the *Mobile-Sierra* standard applies and the facts alleged in that proceeding were insufficient to justify abrogation, any party continuing to seek abrogation must prove changed circumstances arising since the end of the test period in the prior case that demonstrate that Article 11.2 rates are no longer in the public interest.[655]

[651] Salt River Brief Opposing Exceptions at 8 (citing Ex. EPG-328; Tr. 1013:14-24; Tr. 1014:11-15).

[652] APS Brief Opposing Exceptions at 35-36; Salt River Brief Opposing Exceptions at 9.

[653] Salt River Brief Opposing Exceptions at 9.

[654] *2011 Rate Case Suspension Order,* 133 FERC ¶ 61,104 at P 17.

[655] Consequently, arguments raised by El Paso and Competitive Power Suppliers that the Initial Decision erred in applying the *Mobile-Sierra* standard are collateral attacks

(continued…)

450. The Commission finds the Presiding Judge correctly barred relitigation of factors addressed in the prior decision and properly limited the inquiry here to changed or additional circumstances since the end of the test period in the 2008 Rate Case.[656] The Commission has previously addressed the arguments regarding (1) allegations that Article 11.2 shippers should pay for Post-1995 facilities they demanded to be built; (2) assertions that the cause of the rate differential between Article 11.2 and recourse rates is capacity turnbacks by Article 11.2 shippers; and (3) the impact of Article 11.2 shippers contracting for capacity on the Transwestern Expansion. As argued by the Rate Protected Shippers/ACC, APS, Salt River, and Texas Gas Service, these issues were raised and addressed in Opinion No. 517, where the Commission either rejected the factual premise of the arguments or found that the facts did not justify abrogating Article 11.2.[657]

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on Opinion No. 517 and will not be addressed here. Opinion No. 517 relied on the earlier determination in the *March 20 Order* that challenges to Article 11.2 would be made under the *Mobile-Sierra* standard. *See also* Opinion No. 517, 139 FERC ¶ 61,095 at PP 233-234. Competitive Power Suppliers argue that a Supreme Court decision relied on in Opinion No. 517 does not apply because, unlike the challengers in that proceeding, Gila River and New Harquahala did not exist in 1996 and could not have been involved in the 1996 Settlement proceeding. *NRG*, 558 U.S. 165, 174-75 ("We therefore hold that the *Mobile-Sierra* presumption does not depend on the identity of the complainant who seeks FERC investigation."). Competitive Power Suppliers raised this issue in the 2008 Rate Case (see Feb. 14, 2011 brief on exceptions at 25, citing *NRG*), and their arguments will be addressed as needed in the rehearing order in that proceeding.

[656] El Paso Brief on Exceptions at 128; in its Appendix B, El Paso provides an excerpt of its exceptions filed in the 2008 Rate Case in support of its argument that the Commission must consider jointly the record in both dockets. A motion to strike Appendix B was filed by Texas Gas Service, ConocoPhillips, and Freeport on August 31, 2012, arguing that Appendix B constitutes a collateral attack on both Opinion No. 517 and the Commission's December 23, 2010 order barring relitigation of issues. Answers were filed by El Paso and Competitive Power Suppliers. The Commission addressed El Paso's exceptions in the 2008 Rate Case in Opinion No. 517. However, we find that resubmitting the arguments in Appendix B without reflecting the Commission's disposition of the issues is improper relitigation, and we grant the motion to strike. To the extent that El Paso argues changed circumstances to meet the *Mobile-Sierra* criteria in the remainder of its brief, we address such issues in the body of this order.

[657] *See* Opinion No. 517, 139 FERC ¶ 61,095 at P 240. The Commission adopted a similar approach of relying on the determination in prior orders that the factors considered there were insufficient to justify abrogation.

451. The Commission affirms the Presiding Judge's finding that neither El Paso nor Competitive Power Suppliers have demonstrated that the Article 11.2 rates in the instant proceeding will "impair the financial ability of El Paso to provide service, impose excessive burdens on third parties, or be unduly discriminatory such that the public interest is seriously harmed."[658] Thus, neither El Paso nor Competitive Power Suppliers have shown that the Article 11.2 differential meets that standard to justify modifying this provision of the 1996 Settlement. The Presiding Judge correctly held that the rate differential is almost exclusively attributable to El Paso's need to offer discounts in response to competition, primarily in California.[659] In fact, the record shows that the average rate paid by El Paso's discounted shippers is significantly lower than the maximum recourse rates.[660] Moreover, the Article 11.2 shippers took on obligations in the 1996 Settlement that non-parties did not undertake, so there is a reasonable basis for the rate differential between these two shipper classes.

452. The Commission affirms the Presiding Judge's determination that El Paso and Competitive Power Suppliers have failed to demonstrate extraordinary circumstances, excessive third party burdens or undue discrimination required to modify Article 11.2 under the *Mobile-Sierra* standard.

B. Calculation and Recovery of Article 11.2(a) Shortfall (Stipulated Issue IX.C)

453. Because the Article 11.2(a) rates are capped at the 1996 Settlement levels, as adjusted annually for inflation, there is a rate differential between the Article 11.2(a) rates and the maximum recourse rates under Rate Schedule FT-1. Assuming that these rates are the means by which El Paso recovers its allocated cost of service, and the maximum recourse rates are fully allocated, this rate differential creates a revenue shortfall.[661] El Paso proposes to recover a portion of this revenue shortfall by reallocating that shortfall to the non-Article 11.2(a) maximum recourse rate shippers. In Opinion No. 517, the Commission held that El Paso may not reallocate to non-Article 11.2(a) shippers or

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[658] *See* Opinion No. 517, 139 FERC ¶ 61,095 at P 236.

[659] ID, 139 FERC ¶ 63,020 at P 297.

[660] *See, e.g.,* Ex. SRP-1 at 13-14 (showing that the weighted average discount rate, as a percentage of the recourse rate, was 61 percent).

[661] As discussed below, El Paso also incurs a revenue shortfall due to its discounting activities, which shortfall is addressed in the Commission's review of El Paso's discount adjustment proposal.

contracts any shortfall arising as a result of Article 11.2(a) rates being lower than recourse rates.[662] The Commission found:

> [t]he 1996 Settlement was essentially a risk-sharing agreement. While El Paso's risk was mitigated by the possibility that El Paso could remarket turned-back capacity, there is nothing in the 1996 Settlement or the evidence that suggests El Paso would not bear the costs if it failed to remarket. Any remarketing must, naturally, be made at rates that are just and reasonable. To that extent, El Paso assumed the risk in Article 11.2 of any shortfall.[663]

454. In Opinion No. 517, the Commission further found that El Paso had not met its burden to show that it met the criteria in the *Selective Discounting Policy* for a discount adjustment, and presented no other viable justification why its remaining customers should pay for costs foregone in order to implement the 1996 Settlement with the Article 11.2(a) shippers.

455. In the instant case, El Paso calculates that the shortfall between the Article 11.2(a) rates and the maximum recourse rates is $5.3 million, based on its use of a bifurcated cost of service which allocates 1995 costs to all shippers, but post-1995 costs to only non-Article 11.2(a) shippers.[664]

Initial Decision

456. The Presiding Judge found that Opinion No. 517 appears to treat the Article 11.2 shortfall as being tied to discounts and discount adjustments.[665] The Presiding Judge found that Article 11.2(a) does not produce any shortfall because the Article 11.2(a) rates may not be legitimately considered "discounted" rates; instead they are a unique category of maximum recourse rates established in the 1996 Settlement. The Presiding Judge noted that the indicated test period discount adjustment in this proceeding is not

[662] Opinion No. 517, 139 FERC ¶ 61,095 at P 290.

[663] *Id*.

[664] As discussed below in the discussion of Stipulated Issue IX.E, the Commission rejects El Paso's proposed bifurcated cost of service.

[665] ID, 139 FERC ¶ 63,020 at P 299 (citing Opinion No. 517, 139 FERC ¶ 61,095 at PP 256-300).

attributable to Article 11.2(a), but attributable to capacity discounting required by competition.

Briefs on Exceptions

457. El Paso states that it agrees with the Presiding Judge that Article 11.2(a) rates are maximum rates and thus that there is no shortfall.[666]

458. APS, Indicated Shippers, Joint Parties, Rate Protected Shippers/ACC, Texas Gas Service, and Golden Spread[667] argue that the Presiding Judge erred in ruling that there was no shortfall.[668] They argue that no party, including El Paso, disputed the existence of the shortfall, as evidenced by the parties' agreement to this stipulated issue.[669] They further argue that the Presiding Judge erred when he misapplied Opinion No. 517 and found that Article 11.2(a) rates are maximum recourse rates and the shortfall can only arise if the rate is a discounted rate.[670] Joint Parties argue that the Presiding Judge's description of Article 11.2(a) rates as "a unique category of maximum recourse rates" essentially mirrors El Paso's characterization of them as "vintage rates" in the 2008 Rate

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[666] El Paso Brief on Exceptions at 7.

[667] Golden Spread Brief Adopting Exceptions, in which Golden Spread adopted certain exceptions filed by APS, Rate Protected Shippers/ACC, and Texas Gas Service relating to Article 11.2.

[668] APS Brief on Exceptions at 27; Indicated Shippers Brief on Exceptions at 25 (citing *El Paso Natural Gas Co*., 140 FERC ¶ 61,063 at P 14 (directing El Paso to file revised pro forma rates incorporating adjustments to ensure that Article 11.2 shortfalls are not reallocated to other shippers); Opinion No. 517, 139 FERC ¶ 61,095 at P 290); Joint Parties Brief on Exceptions at 11; Rate Protected Shippers/ACC Brief on Exceptions at 6 (citing Opinion No. 517, 139 FERC ¶ 61,095 at P 248); Texas Gas Service Brief on Exceptions at 19.

[669] APS Brief on Exceptions at 27; Indicated Shippers Brief on Exceptions at 25; Joint Parties Brief on Exceptions at 13-14; Rate Protected Shippers/ACC Brief on Exceptions at 5-6, 9 (citing Ex. EPG-211 at 18:3-12, Ex. EPG-107 at 51:20-52:5; El Paso's brief on exceptions in Docket No. RP08-426-000 at 102-03 (Feb. 14, 2011)); Texas Gas Service Brief on Exceptions at 23 (citing Ex. EPG-211 at 18:3-12; Ex. EPG-107 at 51:20-53:15; Tr. at 1847:21-1848:11).

[670] Rate Protected Shippers Brief on Exceptions at 6 (citing ID, 139 FERC ¶ 63,020 at P 299 and Tr. 1157); APS Brief on Exceptions at 27 (citing Opinion No. 517, 139 FERC ¶ 61,095 at P 300); Joint Parties Brief on Exceptions at 12-13.

Case, which the Commission rejected in Opinion No. 517 when it ruled that El Paso may not increase its recourse rates to recoup the revenues it cannot recover from Article 11.2 contracts.[671] APS argues that the Presiding Judge's holding that the Article 11.2(a) rates are a unique category of maximum recourse rates is beyond the scope of the issues set for hearing in this case.[672]

459. Texas Gas Service argues that El Paso's tariff classification of Article 11.2(a) rates as the equivalent of maximum tariff rates for scheduling purposes does not negate the fact that Article 11.2(a) rates are lower than the corresponding zonal recourse rates.[673] Moreover, Texas Gas Service asserts that just because El Paso may not reallocate the Article 11.2(a) shortfall on the grounds that it did not demonstrate that it qualifies for a discount adjustment related to the Article 11.2(a) contracts does not mean the shortfall does not exist.[674] Texas Gas Service and Joint Parties also claim that the Presiding Judge erred in stating there was no shortfall because the test period discount adjustment in this proceeding is not attributable to Article 11.2(a).[675]

460. The Rate Protected Shippers/ACC contend that the Presiding Judge may have confused the shortfall reallocation issue in the 2008 Rate Case (where the Discount Adjustment Policy was relevant) and the shortfall measurement issue in this proceeding.[676] Texas Gas Service explains that El Paso in the present filing was seeking both a discount adjustment related to non-Article 11.2(a) contracts at rates below maximum zonal recourse rates, as well as an increase to the maximum recourse rates by virtue of its proposal to recover the difference between the maximum rates and the

[671] Joint Parties Brief on Exceptions at 12-13 (citing Opinion No. 517, 139 FERC ¶ 61,095 at P 300); APS Brief on Exceptions at 27.

[672] APS Brief on Exceptions at 26 (arguing that whether these rates are vintage or maximum recourse rates was an issue in the 2008 Rate Case and thus subject to the bar on relitigation in this case); *see also* Joint Parties Brief on Exceptions at 11-12.

[673] Texas Gas Service Brief on Exceptions at 20 (citing Tr. at 1157:12-17; Ex. TGS-47 at 3 (citing El Paso's FERC Gas Tariff, General Terms and Conditions (GT&C) section 37.2(e))).

[674] Texas Gas Service Brief on Exceptions at 22.

[675] Texas Gas Service Brief on Exceptions at 23 (citing ID, 139 FERC ¶ 63,020 at P 299); Joint Parties Brief on Exceptions at 14.

[676] Rate Protected Shippers/ACC Brief on Exceptions at 8.

Article 11.2(a) rates.[677] Texas Gas Service states these two separate issues were conflated by the Presiding Judge, while Opinion No. 517 only addressed the issue of whether El Paso could recover the difference between the maximum rates and the Article 11.2(a) rates.[678]

461. APS, Joint Parties, Indicated Shippers, and Texas Gas Service argue that the Presiding Judge's finding of no shortfall contravenes the record and Opinion No. 517, where the Commission held that there is a shortfall and that El Paso must absorb the costs related to a shortfall.[679]

462. Joint Parties and APS argue that the issue before the Presiding Judge was not whether there was a shortfall, but rather the amount of the shortfall. APS, Rate Protected Shippers/ACC, Joint Parties, Indicated Shippers, and Texas Gas Service contend that the amount of the shortfall is about $28 million based on as-filed rates and $25.5 million based on motion rates, which is the difference between the Article 11.2(a) contract revenues and the revenues of the corresponding recourse rate contracts.[680] They argue that El Paso, using a flawed methodology (its proposed bifurcated cost of service), contends that the revenue shortfall is $5.3 million based on El Paso's as-filed rates.[681]

[677] Texas Gas Service Brief on Exceptions at 20-21 (citing Ex. EPG-211 at 31:3-6).

[678] Texas Gas Service Brief on Exceptions at 21 (citing Opinion No. 517, 139 FERC ¶ 61,095 at P 290).

[679] APS Brief on Exceptions at 29; Joint Parties Brief on Exceptions at 12; Texas Gas Service Brief on Exceptions at 19; Rate Protected Shippers/ACC at 9-10.

[680] APS Brief on Exceptions at 25 (citing Ex. APS-1 at 34; Ex. EPG-211); Rate Protected Shippers/ACC Brief on Exceptions at 10 (citing Ex. RPS-1 at 16:3-7 & 16:15-17; Ex. RPS-3; Ex. SWG-37 at 46:5-7; Ex. AEP at 10:1-5); Joint Parties Brief on Exceptions at 15 (citing Ex. AEP-1); Indicated Shippers Brief on Exceptions at 26 (citing Ex. RPS-3; Ex. AEP-3).

[681] Rate Protected Shippers/ACC Brief on Exceptions at 10; APS Brief on Exceptions at 25 (citing Tr. 1813 and Tr. 2773); Joint Parties Brief on Exceptions at 16; Indicated Shippers Brief on Exceptions at 26 (citing Statement of Reasons at 6; Ex. EPG-107 at 51-54; Ex. EPG-211 at 18); Texas Gas Service Brief on Exceptions at 24 (citing Ex. EPG-211 at 18:9-11).

Rate Protected Shippers/ACC, APS, and Joint Parties urge the Commission to reject El Paso's proposed shortfall calculation.[682]

463. APS, Indicated Shippers, Joint Parties, Texas Gas Service, and Rate Protected Shippers/ACC argue that the Initial Decision contravenes the Commission's determination in Opinion No. 517 that El Paso cannot recover any Article 11.2(a) shortfall from non-Article 11.2(a) shippers.[683] They contend that the Commission must quantify the shortfall amount in this proceeding, while APS argues the shortfall amount must be synchronized with and calculated based upon the final recourse rates approved in this case.[684]

Briefs Opposing Exceptions

464. El Paso urges the Commission to affirm the Presiding Judge's ruling that there is no shortfall because Article 11.2(a) rates are unique maximum recourse rates, not discounted rates. El Paso argues that the Presiding Judge correctly cited testimony by El Paso Witness Stires that Section 37 of its tariff treats Article 11.2(a) rates as maximum recourse rates.[685]

465. El Paso argues that the Commission has ruled that El Paso should recover and not be required to absorb its expansion costs, thus confirming that El Paso should recover its expansion costs notwithstanding Article 11.2.[686] Therefore, El Paso asserts that the Article 11.2(a) rate cap was not intended to protect shippers from paying for Post-1995 Expansion costs, or to require El Paso to absorb those costs. According to El Paso, the focus of Article 11.2 was the cost of El Paso's system as it existed in 1995, which left

[682] Rate Protected Shippers/ACC Brief on Exceptions at 15; APS Brief on Exceptions at 28 (citing Ex. RPS-25, Article 6.7 of 2008 Rate Settlement); Joint Parties Brief on Exceptions at 16.

[683] APS Brief on Exceptions at 29; Indicated Shippers Brief on Exceptions at 25-26; Joint Parties Brief on Exceptions at 12 (citing Opinion No. 517, 139 FERC ¶ 61,095 at P 300); Texas Gas Service Brief on Exceptions at 22; Golden Spread Brief adopting exceptions at 2 and 6; Rate Protected Shippers/ACC Brief of Exceptions at 9-10.

[684] Rate Protected Shippers/ACC Brief on Exceptions at 9; APS Brief on Exceptions at 25; Indicated Shippers Brief on Exceptions at 27.

[685] El Paso Brief Opposing Exceptions at 150-151.

[686] El Paso Brief Opposing Exceptions at 154 (citing *March 20 Order,* 114 FERC ¶ 61,290 at P 69; *September 5 Order,* 124 FERC ¶ 61,227 at P 98).

El Paso free to recover the full cost of future, post-1995 expansions and additions. El Paso explains that, to avoid creating a new class of subsidized service, it created a two-step method of cost allocation (a bifurcated cost of service methodology) that results in (1) approximately $3-5 million of 1995 costs that El Paso cannot collect from Article 11.2(a) contracts and proposes to reallocate to non-Article 11.2 contracts, and (2) about $23 million of Post-1995 expansion costs that have been directly allocated to non-Article 11.2(a) contracts, that would otherwise have been reallocated to those contracts under the former approach.[687]

466. El Paso disagrees that its cost allocation method violates the Commission's bar on re-litigating identical issues decided in the 2008 rate case.[688] El Paso asserts it filed its new cost allocation methodology in September 2010, a year and half before Opinion No. 517 was issued. El Paso explains that its cost allocation methodology is new and different from that in the 2008 rate case and proposes a direct cost allocation that shows there is little need to reallocate any costs, and thus presents a new issue that was not at issue in Opinion No. 517.[689]

467. Texas Gas Service urges the Commission to reject the concept that there is no Article 11.2(a) shortfall. Texas Gas Service states that El Paso addresses the shortfall in other sections of its Brief on Exceptions by alleging the difference between the Article 11.2(a) rates and the recourse rates has more than doubled since the 2008 Rate Case. Texas Gas Service argues this is demonstrably overstated because El Paso compares the motion rates in effect subject to refund in the 2011 Rate Case and the final settled rates in the 2008 Rate Case. Texas Gas Service contends that the Article 11.2(a) shippers are differently situated by virtue of having undertaken the burdens of the1996 Settlement; since Article 11.2(a) shippers and maximum recourse rate shippers are not similarly situated, there is a rational basis for charging different rates to these two classes of shippers. Texas Gas Service further argues that El Paso's claims of a growing rate discrepancy creating a burden on non-Article 11.2(a) shippers are false because Opinion No. 517 ruled that El Paso was prohibited from reallocating the Article 11.2(a) shortfall

[687] El Paso Brief Opposing Exceptions at 154-55 (citing Ex. EPG-211 at 15-19, 21-22; EPG-404 at 10-14).

[688] *Id*. at 155 (citing APS Brief on Exceptions at 29; Texas Gas Service Brief on Exceptions at 18).

[689] *Id*. at 156.

to other shippers.[690] Since the costs cannot be reallocated, there is not a burden on other shippers.

Commission Determination

468. Consistent with Opinion No. 517, the Commission finds that El Paso may not reallocate the revenue shortfall that arises due to the rate differential between Article 11.2 rates and recourse rates. Opinion No. 517 extensively addressed the Article 11.2(a) revenue shortfall issue and made the following findings:

> At the hearing, El Paso was not able to show it met the criteria in the [*Selective Discounting Policy*] for a discount adjustment, and presented no other viable justification why its remaining customers should pay for costs foregone in order to implement El Paso's 1996 Settlement with the Article 11.2(a) shippers.[691]

469. The Commission also found in Opinion No. 517 that El Paso failed to justify reallocation based on general cost recovery or cost allocation theories or according to the Commission's vintage rate policies. The Commission stated,

> Finally, El Paso's vintage rate analogy is inapposite, as the decision whether to design rates according to vintage or utilize a roll-in approach is made in the certificate proceeding, not post-hoc in a rate case. El Paso has chosen to roll in the expansion and safety costs into its recourse rates, and we need not revisit that decision here.[692]

470. The Commission summarized its holdings stating, "El Paso may not reallocate to non-Article 11.2(a) shippers or contracts any shortfall arising as a result of Article 11.2(a) rates being lower than recourse rates."[693]

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[690] Texas Gas Service Brief Opposing Exceptions at 16-17 (citing Opinion No. 517, 139 FERC ¶ 61,095 at P 290).

[691] Opinion No. 517, 139 FERC ¶ 61,095 at P 291.

[692] *Id.* P 300.

[693] *Id.* P 290.

471. Thus, the Commission determined that the shortfall arising from Article 11.2(a) rates does not qualify for a discount adjustment, the Article 11.2(a) rates are not vintage rates, and El Paso may not reallocate the shortfall to non-Article 11.2(a) shippers. Those findings may not be relitigated in this proceeding. In fact, Stipulated Issue IX.C, agreed to by all parties, specifies that the issue "is not intended to allow relitigation of whether El Paso should be allowed to reallocate post-1995 costs not recovered from [Article] 11.2(a) contracts."

472. Stipulated Issue IX.C is thus reduced to two simple issues: how to calculate the shortfall and what portion of the shortfall El Paso is allowed to recover. Opinion No. 517 unequivocally answers the second question: "El Paso may not reallocate to non-Article 11.2(a) shippers any shortfall arising as a result of Article 11.2(a) rates being lower than recourse rates." Therefore, the amount of shortfall that may be reallocated in this case is zero. The Commission affirms the Presiding Judge's finding that there is no shortfall that may be reallocated.

473. The issue of the proper calculation of the shortfall is complicated in this case by El Paso's proposal to use a bifurcated cost of service for Article 11.2(a) and non-Article 11.2(a) rates, which results in a much lower shortfall than would result from its traditional cost of service methodology. In the discussion of Stipulated Issue IX.E *infra*, the Commission rejects El Paso's proposed bifurcated cost of service methodology. Without the need to differentiate among customers to allocate the bifurcated cost of service and because the amount of shortfall to be reallocated is zero, the calculation of the shortfall is simplified. The formula for calculating the shortfall has already been established in the 2008 Rate Case proceeding. There the Article 11.2(a) revenue shortfall was defined as "the annual amount related to costs not otherwise recovered due to the Article 11.2(a) rate caps…."[694]

474. The Commission therefore finds and concludes that there is no shortfall amount that El Paso may reallocate to non-Article 11.2(a) shippers. Insofar as the Initial Decision confirmed this requirement, it was correct. However, the Commission does not adopt the Presiding Judge's finding to the extent it assumed there was a zero shortfall amount based on the fact that Article 11.2 rates may be lower than recourse rates. This finding should be modified to ensure that no shortfall amount may be reallocated to non-Article 11.2 shippers. It is not necessary to determine the exact shortfall amount. El Paso is directed to calculate its maximum recourse rates on a fully allocated basis, without regard to any shortfall reallocation to non-Article 11.2 rates. To the extent that El Paso proposed to reallocate any Article 11.2 shortfall to non-Article 11.2 rates, the

[694] Opinion No. 517, 139 FERC ¶ 61,095 at P 256 n.415 (citing Article 6.7 of the 2008 Rate Settlement).

proposal is rejected and El Paso's rates in its compliance filing may not reflect any such reallocation.

C. Impact of Rate Design Changes (Stipulated Issue IX.D)

475. El Paso argues that, because fundamental rate design changes have been proposed by Edison in this proceeding, the issue regarding how Article 11.2 would be affected by such changes needs to be addressed. El Paso argues that, if the Commission adopts a new rate design but does not adjust the Article 11.2 rates to reflect the new rate design, Article 11.2 can be seen as exempting certain shippers from the effects of the Commission's rate design decision.[695]

Initial Decision

476. The Presiding Judge found that this issue is resolved in accordance with the analyses, findings, and conclusions reflected in the Cost Allocation and Rate Design Section of the Initial Decision where he held that the rate design changes proposed by El Paso and other parties were not supported.[696]

Briefs on Exceptions

477. The Rate Protected Shippers/ACC argue that the Presiding Judge erred by ruling that there is nothing forbidding El Paso to "bust the rate cap" of Article 11.2(a) because of approved rate design changes.[697] The Rate Protected Shippers/ACC argue that the Commission resolved this issue as a matter of law in Opinion No. 517, finding that the contract rights of Article 11.2 shippers may not be abrogated absent a *Mobile-Sierra* showing.[698] The Rate Protected Shippers argue that even if there is a rate design change it does create a circumstance that satisfies *Mobile-Sierra* because the Commission has already held that it "is not sufficient to justify contract modification under *Mobile-Sierra* that some shippers pay a different rate under a contract or settlement than other shippers on the system."[699]

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[695] El Paso Initial Brief at 183-185.

[696] ID, 139 FERC ¶ 63,020 at PP 135-247.

[697] Rate Protected Shippers/ACC Brief on Exceptions at 19.

[698] *Id.* (citing Opinion No. 517, 139 FERC ¶ 61,095 at P 232).

[699] *Id.* at 20-21 (citing Opinion No. 517, 139 FERC ¶ 61,095 at P 189); *see also March 20 Order,* 114 FERC ¶ 61,290 at P 35).

478. Texas Gas Service argues that, while the Presiding Judge ruled that this issue was resolved in accordance with the analyses, findings, and conclusions in section VII of the Initial Decision (addressing cost allocation and rate design issues), that section did not address the impact of rate design changes for Article 11.2 contracts. According to Texas Gas Service, El Paso's argument, that it should be allowed to alter how it charges for Article 11.2 contracts if the rate design for other contracts is changed, is flawed because it ignores that there is currently a different rate design for Article 11.2(a) and non-Article 11.2(a) rates. According to Texas Gas Service, just because some shippers pay rates based on one rate design while others pay rates based on another rate design fails to meet any *Mobile-Sierra* public interest standard elements; i.e., the fact that some shippers pay rates based on a distinct rate design does not demonstrate that the rate will impair the financial ability of the pipeline to provide service, impose excessive burdens on third parties, or be unduly discriminatory.[700]

Commission Determination

479. The Commission affirms the Presiding Judge's finding that the issue is resolved in accordance with the cost allocation and rate design determinations in this proceeding. Because the Commission's findings in the Cost Allocation and Rate Design section above do not result in rate design changes, the issue of the impact on Article 11.2 is moot. This issue was further addressed in Opinion No. 517 where the Commission found that reallocation of the Article 11.2 revenue shortfall would be inconsistent with the 1996 Settlement and the Commission's policies.[701]

D. Bifurcated Cost of Service (Stipulated Issue IX.E)

480. In the instant proceeding, El Paso proposes a new two-step method of classifying and allocating costs.[702] El Paso proposes to divide its cost of service into two categories: 1995 facility costs and post-1995 facility costs.[703] First, El Paso allocates the 1995 costs

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[700] Texas Gas Service Brief on Exceptions at 27-30.

[701] Opinion No. 517, 139 FERC ¶ 61,095 at PP 299-300 (discussing the Commission's discount adjustment policy and El Paso's vintage rate analogy).

[702] See Ex. EPG-211 at 15-19, 21-22; Ex. EPG-404 at 10-14.

[703] El Paso Initial Br. at 178-79 (citing Ex. EPG-394 at 54-55). El Paso states it has included in the 1995 facility cost category not just the facilities installed by the end of 1995 but also all post-1995 maintenance as well as all pipeline safety (Pipeline Integrity Program, or PIP) costs. El Paso asserts that no participant challenged the amounts of costs El Paso classified as 1995 costs and post-1995 costs. El Paso asserts that it determined the costs of its 1995 facilities in a very conservative fashion, to ensure that

(continued…)

to all Article 11.2 contracts and maximum rate contracts (non-Article 11.2 contracts) equally and then reallocates 1995 costs not recoverable from Article 11.2(a) contracts to non-Article 11.2(a) maximum rate contracts. In the second step, El Paso directly allocates all of its post-1995 costs to non-Article 11.2(a) maximum rate contracts to provide it an opportunity to recover and not absorb its post-1995 expansion costs and to avoid creating what it calls a new class of subsidized service.[704] The use of this bifurcated cost of service impacts the calculation of the Article 11.2 revenue shortfall (discussed in addressing Stipulated Issue IX.C, above) by reducing the amount of costs that are reallocated to non-Article 11.2(a) that would constitute the shortfall. As a result of this new, two-step process, there is approximately $3-5 million of 1995 costs that El Paso cannot collect from Article 11.2(a) contracts and proposes to reallocate to non-Article 11.2 contracts, and about $23 million of post-1995 expansion costs that have been directly allocated to non-Article 11.2(a) contracts.[705] Use of the prior cost allocation (i.e., allocating 1995 and post-1995 costs equally to all Article 11.2(a) and non-Article 11.2(a) contracts) would result in a reallocation of about $28 million to the non-Article 11.2(a) contracts.

Initial Decision

481. The Presiding Judge held that the issue of bifurcation must be decided only if Article 11.2(a) creates a "shortfall" between Article 11.2(a) rates and non-Article 11.2(a) rates. The Presiding Judge found that there is no Article 11.2(a) shortfall attributable to Article 11.2(a) that may be reallocated to other customers, because El Paso's rates are not "discounted" rates and are a unique category of maximum recourse rates established in the 1996 Settlement.[706] The Presiding Judge found that the indicated test period discount adjustment in this proceeding is not attributable to Article 11.2(a); it is almost exclusively attributable to capacity discounting required by competition.[707] The Presiding Judge held

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the post-1995 category is not overstated and that the comparison of the Article 11.2(a) rate caps with the recourse rate for the 1995 facilities is a fair one. *See* El Paso Initial Br. at 178-79 (citing Ex. EPG-211 at 15:13 – 16:7).

[704] El Paso Initial Br. at 178-79 (citing Ex. EPG-394 at 54-55), El Paso Brief Opposing Exceptions at 155.

[705] El Paso Initial Br. at 178-79 (citing Ex. EPG-394 at 54-55); El Paso's Witness Rezendes states that approximately $5.3 million of the allocated 1995 costs were not recovered from Article 11.2(a) contracts.

[706] *See* ID, 139 FERC ¶ 63,020 at P 301 (citing his determination on Stipulated Issue IX.C: ID, 139 FERC ¶ 63,020 at P 299).

[707] *See id.* P 301.

that no determination is needed on the appropriateness of El Paso's bifurcated cost of service because no shortfall exists.

Briefs on Exceptions

482. The Competitive Power Suppliers, Rate Protected Shippers/ACC, and Texas Gas Service argue that the Presiding Judge erred by failing to reject El Paso's bifurcated cost of service.[708] The Competitive Power Suppliers, Rate Protected Shippers/ACC, and Texas Gas Service argue that El Paso inappropriately separated its total cost of service into 1995 and post-1995 Capacity Costs categories, resulting in an allocation of all costs across two different sets of maximum rate billing determinants, which skews the amount of Article 11.2 revenue shortfall.[709] Because Opinion No. 517 held that El Paso is barred from reallocating unrecovered Article 11.2 costs, Rate Protected Shippers/ACC object to El Paso's bifurcation methodology to minimize its potential exposure to any shortfall in this case and evade the rulings in Opinion No. 517.[710] The Competitive Power Suppliers argue that by using bifurcated cost-of-service models for a single transportation system with rolled-in rates, El Paso attempts to do indirectly that which it cannot do directly, mainly limit its cost responsibility for the Article 11.2 revenue shortfall by shifting over $22 million from El Paso to other non-Article 11.2 shippers.[711]

483. The Rate Protected Shippers/ACC state that El Paso has developed fictitious rates for both its 1995 and post-1995 Capacity Costs. They argue that El Paso arbitrarily reduces the 1995 Capacity Costs rates by overstating the billing determinants to be allocated against the 1995 Capacity Costs and applying 100 percent of the revenue credits associated with short-term firm and Park and Loan services to the 1995 cost of service,

[708] Competitive Power Suppliers Brief on Exceptions at 15; Rate Protected Shippers/ACC Brief on Exceptions at 11; Texas Gas Service Brief on Exceptions at 25.

[709] Competitive Power Suppliers Brief on Exceptions at 15-17; Rate Protected Shippers/ACC Brief on Exceptions at 11; Texas Gas Service Brief on Exceptions at 11-12.

[710] Rate Protected Shippers/ACC Brief on Exceptions at 11, 15; *see also* Competitive Power Suppliers Brief on Exceptions at 16 (citing Opinion No. 517, 139 FERC ¶ 61,095 at PP 289-300).

[711] Competitive Power Suppliers Brief on Exceptions at 16.

and by reducing the billing determinants against which costs were allocated for the post-1995 Capacity Costs rates, to arbitrarily increase them.[712]

484. The Rate Protected Shippers/ACC argue that the correct way to calculate revenue shortfall is to allocate all costs across all maximum rate billing determinants to calculate a maximum recourse rate and then compare the revenues generated under Article 11.2(a) contracts with the revenues otherwise generated if those contracts were priced under those recourse rates. The Rate Protected Shippers/ACC state that the consequence of failing to include Article 11.2(a) contracts' maximum rate billing determinants is to shift the bulk of the actual shortfall to the rates paid under other firm transportation contracts.[713] The Rate Protected Shippers/ACC argue that the Commission essentially decided this issue in this proceeding when it rejected El Paso's original alternate tariff records and held that El Paso's allocation of post-1995 capacity costs to Article 11.2(a) contracts is not an issue in this case.[714]

485. The Rate Protected Shippers/ACC and Texas Gas Service state that the Commission should reject El Paso's bifurcated cost of service based on Opinion No. 517, which states that Article 11.2 rates are neither vintage rates nor discount rates.[715] Texas Gas Service states that El Paso's proposed discount adjustment for non-Article 11.2(a) contracts is a distinct issue from its proposal to reallocate costs it cannot recover from Article 11.2(a) contracts to other contracts, which led to the Presiding Judge's failure to address El Paso's bifurcated cost of service proposal. Texas Gas Service argues that El Paso's bifurcated cost of service proposal is no different than El Paso's vintage rate proposal litigated in the 2008 Rate Case and therefore cannot be relitigated in this proceeding.[716] The Rate Protected Shippers/ACC argue that it is well understood that El Paso operates an integrated pipeline system, "marketing undifferentiated capacity which cannot be physically attributed to pre-1995 or post-1995 capacity."[717] The Rate Protected Shippers/ACC further state that because El Paso rolls the costs of its facilities

[712] Rate Protected Shippers/ACC Brief on Exceptions at 16-17 (citing Rate Protected Shippers Initial Br. 21-24; Rate Protected Shippers Reply Br. 39).

[713] *Id.* at 12.

[714] *Id.* at 15-16.

[715] Rate Protected Shippers/ACC Brief on Exceptions at 14 (citing Opinion No. 517 at PP 299-300); Texas Gas Service Brief on Exceptions at 26.

[716] Texas Gas Service Brief on Exceptions at 25-26.

[717] Rate Protected Shippers/ACC Brief on Exceptions at 14 (citing *September 5 Order,* 124 FERC ¶ 61,227 at P 98).

into a single cost of service for ratemaking purposes, there are no separate vintages of capacity.[718]

Briefs Opposing Exceptions

486. El Paso argues that the Commission has held in several orders that El Paso should be allowed to recover, and not be required to absorb, the costs of its post-1995 expansions because those costs are not implicated by the Article 11.2 rate cap.[719] El Paso states that the Commission further held that the rate cap does not apply to the Line 2000 or Power-up Project expansions and that El Paso should recover and not be required to absorb its expansion costs.[720] El Paso argues that the clear effect of these orders is that the Article 11.2(a) rate cap was not intended to protect shippers from paying for post-1995 Expansion costs or to require El Paso to absorb those costs; i.e., El Paso would not be required to provide "subsidized" expansion service.[721]

487. El Paso argues that, while it proposed full cost recovery in the 2008 Rate Case, its proposed cost allocation in that case did not clearly distinguish between its 1995 cost and its post-1995 costs; instead, El Paso allocated its combined 1995 and post-1995 costs to all maximum rate contracts equally, and then reallocated costs not recoverable from Article 11.2(a) contracts to non-Article 11.2(a) contracts. El Paso states that, in the instant case, El Paso proposes a two-step method of cost allocation to make compliance with the Commission's prior directives clearer and more transparent.[722]

488. El Paso argues that it could not have developed this methodology to avoid the Commission's bar on the reallocation of the Article 11.2 Shortfall Quantity costs in

[718] *Id.* at 14 (citing Ex. RPS-1 at 17:5-14; Ex. TGS-13 at 12:13-18).

[719] El Paso Brief Opposing Exceptions at 153 (citing *March 20 Order,* 114 FERC ¶ 61,290 at P 69: "The specific method of including the costs in the rates can be addressed at the hearing, but the Commission makes clear that Article 11.2(a) does not preclude inclusion of the costs of these expansions in all shippers' rates in this proceeding;" *id.* P 82).

[720] El Paso Brief Opposing Exceptions at 154 (citing *March 20 Order,* 114 FERC ¶ 61,290 at PP 68-69; *September 5 Order*, 124 FERC ¶ 61,227 at P 98, stating that "The Commission finds it unreasonable to interpret Article 11.2(b) to require El Paso to absorb such costs, which only arise because of the expansions.").

[721] El Paso Brief Opposing Exceptions at 154.

[722] *Id.* at 154-155.

Opinion No. 517, as alleged by the Rate Protected Shippers/ACC, because it developed and filed this methodology in September 2010, over a year and a half before the issuance of Opinion No. 517, and several months before the issuance of the initial decision in the 2008 case. El Paso argues that because it is proposing a new methodology, the bifurcated cost of service methodology was not an issue in Opinion No. 517 and is thus not subject to the bar on relitigation of "identical" issues. Similarly, El Paso argues that its new cost allocation methodology is not premised on the vintage rate argument addressed in Opinion No. 517 because that argument addressed rates, not cost allocation. El Paso argues that the Commission could not have been considering, much less rejecting, a cost allocation proposal it had not yet seen.[723]

489. El Paso argues that Opinion No. 517 contemplated that Article 11.2(a) shippers would pay "fully allocated" rates for post-1995 expansion costs under their non-Article 11.2(a) maximum rate contracts; El Paso's new cost allocation allocates the unrecovered costs directly, thus achieving "fully allocated" rates.[724] El Paso argues that the Commission's prior ruling rejecting El Paso's proposed alternate tariff records has nothing to do with this issue, since the alternate tariff records required Article 11.2(a) contracts to pay a portion of the post-1995 costs, which is a result opposite that obtained from the bifurcated cost of service.

<u>Commission Determination</u>

490. The Commission finds that El Paso's proposed bifurcated cost of service is not just and reasonable because it would improperly shifts costs from the Article 11.2 shippers to non-Article 11.2 shippers. As discussed below, the Commission affirms the Presiding Judge's rejection of El Paso's reallocation proposal and reaffirms its holding in Opinion No. 517.[725] El Paso's bifurcated cost of service calculation is inconsistent, in its operation, with Opinion No. 517. In Opinion No. 517, the Commission affirmed the finding of the presiding judge in that proceeding that "El Paso may not reallocate to non-Article 11.2(a) shippers or contracts any shortfall arising as a result of Article 11.2(a) rates being lower than recourse rates . . . . El Paso assumed the risk in Article 11.2 of any shortfall."[726] The Commission finds that El Paso has not justified its bifurcation proposal

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[723] *Id.* at 156-57.

[724] *Id.* at 157 (citing Opinion No. 517, 139 FERC ¶ 61,095 at PP 322, 325, 330).

[725] Opinion No. 517, 139 FERC ¶ 61,095 at PP 289-300 (rejecting El Paso proposals to recover Article 11.2 shortfall under the Commission's discount adjustment and vintage rate policies and general ratemaking principles).

[726] *Id.* P 290.

to ensure cost recovery of post-1995 costs, and thereby minimize an Article 11.2(a) revenue shortfall, by allocating those costs solely to non-Article 11.2(a) contracts.

491. In Opinion No. 517, the Commission rejected El Paso's various arguments for allowing it to recover the Article 11.2 shortfall, finding that El Paso had misread a prior Commission order as "giving tacit assent to novel theories to justify recovery of the Article 11.2 shortfall."[727] Opinion No. 517 held that "El Paso has failed to justify reallocation based on general cost recovery or cost allocation theories."[728] In addition, the Commission found that El Paso had failed to support treating the Article 11.2 rates as vintage rates or discounted rates. The Commission finds that El Paso's proposed bifurcated cost of service is another such novel theory that fails to justify recovery of the Article 11.2 shortfall.

492. El Paso operates an integrated system, "marketing undifferentiated capacity which cannot be physically attributed to pre-1995 or post-1995 capacity. That is because it operates its system as an integrated whole and uses all its capacity to serve the demands of all its customers."[729] The costs of the post-1995 facilities (i.e., the expansion facilities that were constructed after the 1996 Settlement) are rolled-into a single cost of service for ratemaking purposes. As the Commission found in Opinion No. 517, Article 11.2 rates are not vintage rates. Article 11.2(a) shippers receive firm service under the same rate schedule as non-Article 11.2(a) shippers. But for Article 11.2 settlement rates, service to Article 11.2 shippers would be provided at maximum recourse, fully allocated rates. Nor are the Article 11.2(a) rates incremental rates for incremental mainline capacity or incremental facilities dedicated to Article 11.2(a) shippers. El Paso acknowledges that in the 2008 Rate Case, it did not separately allocate 1995 and post-1995 costs but instead allocated its combined 1995 and post-1995 costs to all maximum rate contracts equally. The difference between the Article 11.2(a) capped rate and the fully allocated maximum recourse rate is the shortfall that El Paso proposed to reallocate to the non-Article 11.2(a) shippers in the 2008 Rate Case and that the Commission rejected in Opinion No. 517.

493. Perhaps anticipating that the Commission would reject its proposal to reallocate the shortfall to non-Article 11.2(a) contracts in the 2008 Rate Case, El Paso proposed an alternative method of achieving recovery of the shortfall in the instant case. El Paso argues that the new methodology was intended to comply with the Commission's earlier directives that El Paso should be able to recover and not be required to absorb the

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[727] *Id.* P 299 (citing *March 20 Order,* 114 FERC ¶ 61,290 at PP 20, 27, 43).

[728] *Id.*

[729] *September 5 Order,* 124 FERC ¶ 61,227 at P 98.

expansion costs.[730] However, the methodology runs afoul of El Paso's Article 11.2 obligations. El Paso is proposing to redefine what constitutes the maximum rate applicable to Article 11.2(a) services. It does so by claiming that these services only incur 1995 costs and that these services are separable from like services provided on its integrated system. El Paso supports none of these claims. Rather, El Paso's sole objective is to allocate the post-1995 costs to the non-Article 11.2 contracts to ensure cost recovery, which artificially lowers the Article 11.2 revenue shortfall.

494. The Commission orders cited by El Paso are not on point. In the *March 20 Order,* the Commission addressed concerns that the expansion costs would be allocated only to the East of California shippers, stating that

> [A]bsent changed circumstances, the costs of these facilities should be rolled-in to El Paso's rates in this proceeding. Therefore, the rates of these facilities will be allocated to all of El Paso's customers, and concerns that the costs would be allocated only to the East of California customers is unfounded. The specific method of including the costs in the rates can be discussed at the hearing, but the Commission makes clear that Article 11.2(a) does not preclude inclusion of the costs of these expansions in all shippers' rates in this proceeding.[731]

495. The Commission thus found that the expansion facility costs would be allocated to all shippers, but did not direct that only non-Article 11.2 shippers be allocated those costs. Rather, to the extent some of the expansion costs are allocated to Article 11.2 services, El Paso would not be able to recover those costs so allocated, by virtue of the bargain it struck in the 1996 Settlement.

496. Similarly, in the second case cited by El Paso, the Commission addressed concerns about the application of Article 11.2(b) (i.e., excluding the costs of unsubscribed or discounted 1995 capacity from the rates Article 11.2(a) shippers pay under non-Article 11.2(a) contracts). Excluding unsubscribed or discounted 1995 capacity costs from the rates paid by Article 11.2(a) shippers is a distinct and separate issue from reallocating the

[730] El Paso Brief Opposing Exceptions at 154 (citing *March 20 Order,* 114 FERC ¶ 61,290 at P 69; *September 5 Order,* 124 FERC ¶ 61,227 at P 98 ("The Commission finds it unreasonable to interpret Article 11.2(b) to require El Paso to absorb such costs, which only arise because of the expansions.")).

[731] *March 20 Order,* 114 FERC ¶ 61,290 at P 69.

rate differential between Article 11.2(a) rates and non-Article 11.2(a) rates and does not support El Paso's argument.

497. While El Paso correctly states that it could not have devised the bifurcated cost of service proposal to avoid Opinion No. 517's bar on the reallocation of shortfall costs to non-Article 11.2(a) contracts simply because it filed its proposal months before Opinion No. 517 issued, the bifurcated cost of service effectively acts to achieve that result.[732] El Paso appears to argue that the Commission's bar against reallocating the shortfall is trumped by prior Commission findings that the expansion costs can be rolled-in to system rates. To the contrary, the Commission has not guaranteed cost recovery of the expansion costs but, as with all costs included in rate base, only guarantees the pipeline the opportunity to recover such costs. El Paso's inability to market that capacity at maximum recourse rates does not justify the reallocation of the Article 11.2 revenue shortfall to maximum recourse rate shippers, by a bifurcated cost of service or any other methodology.

498. As with the discount adjustment and vintage rate theories rejected in Opinion No. 517, El Paso's bifurcated cost of service is rejected as an improper attempt to shift unrecovered costs associated with the Article 11.2 services to non-Article 11.2 shippers. As El Paso has not demonstrated that it is just and reasonable to recover any agreed-to shortfall from other, non-Article 11.2 customers already paying fully-allocated recourse rates, El Paso must assume the shortfall itself. El Paso is directed to make adjustments as discussed in the Cost Allocation and Rate Design section above. Issues relating to the calculation of the shortfall are addressed in the Commission's discussion of Stipulated Issue IX.C, above.

E. Article 11.2(b) Compliance and Remedy (Stipulated Issue IX.F/G)

499. Under Article 11.2(b) of the 1996 Settlement,[733] the rates charged to certain settlement shippers may not include certain unsubscribed or discounted capacity costs. In

[732] The Commission finds that this issue was not decided when the Commission rejected El Paso's Alternate Tariff records in this proceeding, as argued by the Rate Protected Shippers/ACC. As El Paso argues, the Alternate Tariff records proposed allocating a portion of the post-1995 costs to the Article 11.2(a) rates, which is the opposite result of the bifurcated cost of service.

[733] Article 11.2(b) provides:

(b) Unsubscribed Capacity Costs. El Paso agrees that the firm rates applicable to service to any Shipper to which this paragraph 11.2 applies will exclude any cost, charge, surcharge, component, or add-on in any way related to the capacity of its system on December 31, 1995, to deliver gas on a forward haul basis to the Shippers listed on Pro

(continued…)

the *March 20 Order,* the Commission established a presumption that this requirement would not be triggered if El Paso had subscribed service of at least 4,000 MMcf/d (a rough equivalent of the capacity El Paso had under subscription in 1995) priced at the rate cap or above.[734] The Commission later explained that "the first 4,000 MMcf/d presumption ensures that El Paso must have subscribed capacity at maximum rates that is equivalent to the capacity that existed on its system in 1995 before it can propose to include the cost of unsubscribed or discounted capacity in the rates of eligible shippers."[735]

500. In Opinion No. 517, the Commission clarified that the presumption was established to "simplify compliance" and that it is "not the only method for determining compliance with Article 11.2(b)."[736] The Commission found:

> [A]n Article 11.2(b) analysis includes two parts: (1) a calculation of whether El Paso's firm contracts at or above the rate cap exceed 4,000 MMcf/d and (2) a determination of whether El Paso proposes to shift the costs of unsubscribed or discounted capacity to the rates of Article 11.2(b) shippers.[737]

501. Consequently, "if the presumption is not met, other evidence might show that Article 11.2(b) is otherwise satisfied."[738] The Commission found in Opinion No. 517 that the presiding judge in that proceeding had failed to count non-forward haul firm services, maximum rate firm contracts that are not counted as billing determinants (maximum rate short-term firm, short haul, backhaul, east flow, and production area contracts), and CRNs (capacity reserved for hourly services) in determining whether the

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Forma Tariff Sheet Nos. 33-35, that becomes unsubscribed or is subscribed at less than the maximum applicable tariff rate as escalated pursuant to paragraph 3.2(b). El Paso assumes full cost responsibility for any and all existing and future step-downs or terminations and the associated CD/billing determinants related to the capacity described in this subparagraph (b).

[734] *March 20 Order,* 114 FERC ¶ 61,290 at P 60.

[735] *September 5 Order,* 124 FERC ¶ 61,227 at 98.

[736] Opinion No. 517, 139 FERC ¶ 61,095 at P 323.

[737] *Id.* P 322.

[738] *Id.* P 323.

presumption had been met.[739] The Commission further found that the maximum rate equivalent (MRE) of discounted contracts cannot be counted toward the presumption.[740]

Initial Decision

502. At hearing, the Presiding Judge was asked to examine two stipulated issues: (1) whether El Paso satisfied the requirements of Article 11.2(b) either by meeting the Commission's presumption or by another means; and (2) if El Paso has not met the presumption or otherwise satisfied the requirements of Article 11.2(b), how to determine the refund. The Presiding Judge did not address either issue, but instead found that these issues were moot because the Commission held in Opinion No. 517 that El Paso had met the Article 11.2(b) presumption in the 2008 rate case.[741]

Briefs on Exceptions

503. El Paso notes that the Presiding Judge found that Article 11.2(b) is "triggered" in this proceeding, which El Paso states could be read to imply that El Paso has not satisfied the requirements of Article 11.2(b), but neither does the Initial Decision express a finding that El Paso has not met the requirements. El Paso notes that the Presiding Judge states that the issue of Article 11.2(b) is "moot" citing Opinion No. 517, which held that El Paso had satisfied the 4,000 MMcf/d presumption in the 2008 Rate Case. El Paso interprets this statement as finding that it has satisfied the requirements of Article 11.2(b) in this case and takes exception to the extent the Initial Decision could be read to imply that it has not met the requirements of Article 11.2(b). El Paso argues that, although the Commission did not count the maximum rate equivalent of discounted contracts toward the presumption, it left the door open in a future rate case to including those revenues in a cost/revenue analysis or other measure, if needed to show that none of the costs of the 1995 forward haul system not recovered by unsubscribed or discounted capacity have been shifted to Article 11.2 shippers.[742] El Paso states that the record demonstrates that it has satisfied the requirements of Article 11.2(b), both by satisfying the Commission's 4,000 MMcf/d presumption using a peak day capacity analysis, and under alternative revenue/cost analyses, which show El Paso clearly has sold sufficient capacity to cover

[739] *Id.* PP 325-328.

[740] *Id.* P 329.

[741] ID, 139 FERC ¶ 63,020 at P 303 (citing Opinion No. 517, 139 FERC ¶ 61,095 at PP 322-330).

[742] El Paso Brief on Exceptions at 137-39 (citing Opinion No. 517, 139 FERC ¶ 61,095 at P 329, *see also* PP 322, 323).

the costs of its 1995 capacity, and therefore the Commission should find that El Paso has satisfied the Article 11.2(b) requirements.[743]

504. The Rate Protected Shippers/ACC, APS, and Texas Gas Service argue that the Presiding Judge erred in failing to determine whether El Paso met the Article 11.2(b) requirements.[744] Texas Gas Service argues that, because there are different contract sets in the 2008 Rate Case and 2011 Rate Case proceedings, the new data in this proceeding must be analyzed to determine whether El Paso continues to meet the 4,000 MMcf/d presumption.[745]

505. Rate Protected Shippers/ACC, APS, and Texas Gas Service argue that El Paso failed to demonstrate that it has 4,000 MMcf/d of subscribed capacity priced at or above the Article 11.2(a) rate to meet the Commission's presumption in this case.[746] They argue that applying the findings in Opinion No. 517 results in a failure to meet the 4,000 MMcf/d presumption.[747] APS and Rate Protected Shippers/ACC argue that following the Opinion No. 517 findings requires the exclusion of Article 11.2(a) maximum rate equivalents of long-term and short-term discount-adjusted contracts priced below the Article 11.2(a) rate caps, which El Paso had included to meet the 4,000 MMcf/d presumption.[748] APS, Rate Protected Shippers/ACC, and Texas Gas Service calculate that El Paso's total firm maximum rate capacity falls short of the 4,000 MMcf/d presumption (which is 4,068 MDth/d using the system 1.017 conversion factor) by between 580-614 MDth/d.[749]

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[743] *Id.* 137-44.

[744] Rate Protected Shippers Brief on Exceptions at 22; APS Brief on Exceptions at 33-34; Texas Gas Service Brief on Exceptions at 30-31.

[745] Texas Gas Service Brief on Exceptions at 31-32.

[746] Rate Protected Shippers/ACC Brief on Exceptions at 22; APS Brief on Exceptions at 34; Texas Gas Service Brief on Exceptions at 32-33.

[747] Rate Protected Shippers/ACC Brief on Exceptions at 25; Texas Gas Service Brief on Exceptions at 32 APS Brief on Exceptions at 35-37.

[748] APS Brief on Exceptions at 36-37.

[749] *Id.* at 37 (580 MDth/d using normalized test period data see Ex. EPG-401); Rate Protected Shippers/ACC Brief on Exceptions at 25-26 (citing Ex. EPG-439 for 614 MDth/d using actual data, or Ex. EPG-401 for 580 MDth/d using normalized data); Texas Gas Service Brief on Exceptions at 32-33 as corrected by Texas Gas Service Brief

(continued…)

506. Rate Protected Shippers/ACC argue that the "other evidence" provided by El Paso to show it had met the 4,000 MMcf/d presumption is meaningless. Rate Protected Shippers/ACC argue that the peak day analysis is methodologically flawed because the annualized peak month quantities have no operational significance; El Paso does not set aside such a quantity each month for a shipper to use in other months. In addition, El Paso improperly includes discounted capacity, contrary to Opinion No. 517.[750] APS characterizes El Paso's peak month analysis as an "apples to oranges" comparison because it compares peak demands with the 4,000 MMcf/d presumption which is expressed in terms of average annual capacity.[751] APS and Rate Protected Shippers/ACC argue the use of non-coincident peak contracts improperly double counts capacity towards the presumption.[752]

507. Texas Gas Service, APS, and Rate Protected Shippers/ACC argue that El Paso's alternative revenue study comparing its total revenues of $608 million with its 1995 capacity costs of $482 million is also flawed and does not support a finding that El Paso has met the Article 11.2(b) requirements.[753] APS and Rate Protected Shippers/ACC argue that this revenue study should be rejected because it compares total revenues, including revenues generated by new, post-1995 expansion capacity, to the costs of 1995 capacity.[754] Rate Protected Shippers/ACC and Texas Gas Service further argue that El Paso is counting revenues from contracts discounted below the Article 11.2(a) rate caps.[755] Texas Gas Service adds the calculations are further flawed because they assume the revenues resulting from the maximum rates were calculated based on a rate base and equity capital structure that the Commission found to be overstated by hundreds of

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Opposing Exceptions at 21, n.94 (580 MDth/d shortfall using normalized billing determinants, 614 MDth/d using updated, un-normalized contract data).

[750] Rate Protected Shippers/ACC Brief on Exceptions at 29 (stating that discounted capacity is included at lines 90-101 (LTF discounted) and 103-154 (STF discounted) of Ex. EPG-402).

[751] APS Brief on Exceptions at 38.

[752] APS Brief on Exceptions at 38; Rate Protected Shippers Brief on Exceptions at 29.

[753] Texas Gas Service Brief on Exceptions at 35-36; APS Brief on Exceptions at 39; Rate Protected Shippers Brief on Exceptions at 28.

[754] APS Brief on Exceptions at 39.

[755] Rate Protected Shippers/ACC Brief on Exceptions at 28; Texas Gas Service Brief on Exceptions at 35.

millions of dollars, and based on the previously rejected assumption that El Paso may reallocate the Article 11.2(a) shortfall.[756]

508. Texas Gas Service, Rate Protected Shippers/ACC, and APS argue that, since El Paso failed to meet the Article 11.2(b) requirements, the Commission must determine the appropriate remedy.[757] Rate Protected Shippers/ACC explain that APS, Texas Gas Service, and Rate Protected Shippers each submitted testimony on the appropriate Article 11.2(b) remedy, proposing Article 11.2(b) revenue credit/rate adjustments.[758] The Presiding Judge struck portions of the testimony that addressed the mechanics of developing the revenue credit/rate adjustment, but the evidence remains in the record under offers of proof.[759] Rate Protected Shippers/ACC state that the amounts of Article 11.2(b) revenue credit/rate adjustments calculated by the three witnesses (based on assumed Article 11.2(a) shortfalls greater than that which results from the Opinion No. 517 findings) are: (1) $98 million – Texas Gas Service; (2) $67.4 million – Rate Protected Shippers; and (3) $47.6 million – APS. Rate Protected Shippers/ACC explain that the difference in the results stems from (1) different assumptions regarding the pertinent amount of discounted capacity that, if sold at or above the Article 11.2(a) rate, would have resulted in El Paso meeting the 4,000 MMcf/d presumption and (2) different methods in valuing the additional capacity needed to meet the 4,000 MMcf/d presumption.[760]

509. Rate Protected Shippers/ACC argue that the Rate Protected Shippers witness' use of a weighted average valuation method is the most neutral and fair; adjusted for the Opinion No. 517 rulings, the adjustment would be $36.7 million, which results in only $15.7 million that El Paso would be required to absorb, because the revenue credits affect only Article 11.2(b) rates.[761]

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[756] Texas Gas Service Brief on Exceptions at 36.

[757] APS Brief on Exceptions at 40; Texas Gas Service Brief on Exceptions at 38; Rate Protected Shippers/ACC Brief on Exceptions at 32.

[758] Rate Protected Shippers/ACC Brief on Exceptions at 31-32; APS Brief on Exceptions at 41-42; Texas Gas Service Brief on Exceptions at 38-40.

[759] Rate Protected Shippers/ACC Brief on Exceptions at 32 n.98 (citing testimony and exhibits).

[760] *Id.* at 33-34.

[761] *Id.* at 36-37.

510. APS argues that the Presiding Judge properly struck all testimony directed at the method of calculating a remedy, based on the Commission's bar on relitigation of Article 11.2 issues identical to those then pending before the Commission in the 2008 Rate Case. APS argues that because the issues were litigated in the 2008 Rate Case but left unresolved in Opinion No. 517, the evidentiary circumstances present the Commission with the option of directing El Paso to file a remedy in a compliance filing based on test period discounted contracts in this docket.[762]

Briefs Opposing Exceptions

511. El Paso argues that several Article 11.2 shippers err in advancing theories about what the proper "remedy" should be if the Commission concludes El Paso has not met the requirements of Article 11.2(b). El Paso argues that the adoption of the request by Texas Gas Service, the Rate Protected Shippers and APS, that the Commission proceed immediately to specify an appropriate method for calculating this "remedy" or rate adjustment, without further input or evidence from parties, would clearly deny parties their statutory right to provide evidence on this issue.[763] SoCal Gas/San Diego agree with El Paso that it has satisfied the Article 11.2(b) requirements and oppose the exceptions urging the Commission to adopt a remedy. SoCal Gas/San Diego argue that due process requires that the present record be supplemented with evidence reflecting the present facts on the issues not decided in the 2008 Rate Case nor litigated here.[764]

512. Competitive Power Suppliers argue that APS, Rate Protected Shippers, and Texas Gas Service are wrong in arguing that El Paso failed to meet the presumption. Competitive Power Suppliers argue that El Paso has satisfied the requirements of Article 11.2(b) in two different ways by using a peak day capacity analysis and an alternative total revenues/cost analysis that shows that El Paso sold sufficient capacity to cover its 1995 capacity costs so that the Article 11.2(b) Shippers do not bear any costs associated with unsubscribed or discounted 1995 forward haul capacity. Competitive Power Suppliers argue that this peak day capacity analysis takes into consideration the large amount of firm maximum rate transportation contracts that have sculpted maximum capacity commitments and ensures El Paso is not penalized for the impact of unorthodox sculpted contracts, many of which are a result of prior Commission orders in the Capacity Allocation Proceeding. Competitive Power Suppliers argue that the total revenues/costs analysis confirms that El Paso is not shifting any 1995 costs not recovered from unsubscribed or discounted capacity to contracts held by Article 11.2 shippers.

[762] APS Brief on Exceptions at 33-34.

[763] El Paso Brief Opposing Exceptions at 161.

[764] SoCal Gas/San Diego Brief Opposing Exceptions at 57.

Competitive Power Suppliers argue that both of these methodologies ensure that Article 11.2(a) shippers are not charged for unrecovered 1995 costs, contrary to the assertions of APS, the Rate Protected Shippers, and Texas Gas Service. Competitive Power Suppliers argue that the Commission should affirm the Initial Decision's ruling that no Article 11.2(b) rates are required and determine based on the evidence in this proceeding that El Paso satisfies the requirements of Article 11.2(b), which will avoid a new compliance proceeding.[765]

513. Competitive Power Suppliers argue that granting the Article 11.2 shippers' request for the Commission to determine the methodology for establishing any Article 11.2(b) rates would be a violation of their due process rights as well as those of others. Competitive Power Suppliers argue that they relied on the Commission's statements that Article 11.2 issues should not be re-litigated in this proceeding. Competitive Power Suppliers argue that the Article 11.2(b) rate proposals cited by APS, Rate Protected Shippers/ACC, and Texas Gas Service have not been subject to cross-examination or extensive briefing by the parties; the questions raised cannot be resolved based on the record developed, and the fact that the Commission did not reach the issue in Opinion No. 517 does not change that fact. Competitive Power Suppliers state that this issue could be resolved in a compliance phase of this proceeding where a full record could be developed to determine the proper way to determine any Article 11.2(b) rates.[766]

514. Competitive Power Suppliers argue that there are many issues that arise regarding Article 11.2(b) rates due to the lack of cross-examination and full briefings, including (1) alternatives to the revenue credit methodologies proposed by APS, Rate Protected Shippers, and Texas Gas Service; (2) what changes to the proposed methodologies should be made in light of Opinion No. 517; (3) should any revenue credit methodology utilize an analysis in descending order of the TSAs with the lowest level of discounting below the applicable Article 11.2(a) rate being considered first; (4) is the level of rate discounting in each TSA determined under El Paso's zonal rate structure based on the absolute difference between the discount rate and the applicable Article 11.2(a) rate or on the total annual revenue under the TSA; (5) how should the revenue credit be evaluated if the discounted rate agreement capacity is less than any contract quantity deficit found below the 4,000 MMcf/d presumption; (6) what are the differences between the APS, Rate Protected Shippers, and Texas Gas Service methodologies and why do they differ; (7) APS' methodology applies an "equal percentage" rate increase to all discount rate agreements until contract quantity of such contracts overcomes any Article 11.2(b) quantity deficit and in the process overstates the revenue credit; (8) Rate Protected

[765] Competitive Power Suppliers Brief Opposing Exceptions at 9.

[766] *Id.* at 12-13 n.28.

Shippers' methodology is based on the annual weighted average rate of all discount rate agreements and not the rates based on the lowest discount first; and (9) Texas Gas Service's methodology improperly utilizes the TSAs to California which have the largest absolute discounts. Competitive Power Suppliers argue that the Commission should find that El Paso has met the Article 11.2(b) presumption or in the alternative require El Paso to submit a compliance filing that would be subject to protest, comments by the parties, cross comments by the parties, reply comments by El Paso, and the possibility of the issues set for limited hearing.[767]

515. Texas Gas Service argues that Competitive Power Suppliers' claim that the Presiding Judge found that El Paso had met the Article 11.2(b) requirements does not stand up to reasoned analysis, for the Presiding Judge did not address the issue.[768] Texas Gas Service and Rate Protected Shippers/ACC similarly oppose El Paso's claim that it was an error for the Presiding Judge to fail to expressly find that El Paso had met those requirements.[769] Texas Gas Service contends that El Paso's argument that discounted rate revenues should be counted toward meeting the Article 11.2(b) requirements is contrary to the language of Article 11.2(b) and inconsistent with the Commission's holdings as to the meaning of Article 11.2(b) and should thus be rejected.[770]

516. Texas Gas Service also argues that El Paso's peak day analysis is flawed because it counts the maximum rate equivalent of discounted contracts toward the presumption and shifts the costs of the other days upon which that capacity is unsubscribed to the Article 11.2 shippers.[771] Rate Protected Shippers/ACC argue that El Paso's peak day capacity analysis is methodologically flawed because it annualizes each contract's sculpted non-coincident peak month MDQ and inflates the amount of subscribed capacity whereas Rate Protected Shippers and others used only *annual average* billing determinants associated with El Paso's firm non-discounted contracts for purposes of the Article 11.2(b) presumption analysis.[772] Rate Protected Shippers/ACC argue that El Paso

[767] Competitive Power Suppliers Brief Opposing Exceptions at 14-16.

[768] Texas Gas Service Brief Opposing Exceptions at 20.

[769] Texas Gas Service Brief Opposing Exceptions at 20; Rate Protected Shippers/ACC Brief Opposing Exceptions at 13 n.54.

[770] Texas Gas Service Brief Opposing Exceptions at 21 (citing Opinion No. 517, 139 FERC ¶ 61,095 at P 330).

[771] *Id.* at 22.

[772] Rate Protected Shippers/ACC Brief Opposing Exceptions at 14.

is wrong to rely on a prior Commission statement that, as a general matter, sculpted contracts "pose difficulties to El Paso in managing and contracting for off-peak capacity that has no associated peak capacity;"[773] the Commission clarified that this statement was made in response to arguments made on rehearing in that proceeding only and "should not be taken as findings of fact applicable to the circumstances that may arise in future proceedings."[774] Rate Protected Shippers/ACC argue that El Paso's peak day analysis double and triple count the same capacity. Rate Protected Shippers/ACC argue that Opinion No. 517 made clear that undersubscribed capacity subject to such a "maximum rate equivalent" adjustment cannot count for purposes of demonstrating compliance with the Article 11.2(b) presumption.[775]

517. Rate Protected Shippers/ACC argue that El Paso's "alternative revenue test" to show that its total revenues significantly exceed its 1995 facilities costs and thus demonstrate compliance with the requirements of Article 11.2(b) is not relevant because the supposed test suggests that Article 11.2(b) was intended to promote adding more capacity and selling that capacity at deeply discounted rates. Rate Protected Shippers/ACC argue that El Paso concedes that Opinion No. 517 prohibits counting discounted capacity towards compliance with the Article 11.2(b) presumption and that El Paso's alternate revenue tests are entirely a results-oriented argument and an end run around compliance with Article 11.2(b).[776] Texas Gas Service argues that the Commission should reject El Paso's revenue test because including discount rate revenues and counting revenues from post-1995 capacity are inconsistent with the language of Article 11.2(b).[777]

518. Texas Gas Service objects to the Presiding Judge's striking of all testimony regarding a remedy, since the Presiding Judge based his ruling on the flawed premise that the Commission would rule on an Article 11.2(b) remedy methodology in Opinion No. 517, which remedy could be used in this proceeding by plugging in the new facts (i.e., the

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[773] *Id.* at 15 n.60 (citing El Paso Brief on Exceptions at 140, which cites to *El Paso Natural Gas Co.,* 139 FERC ¶ 61,096 at P 104 (rehearing order on technical conference issues).

[774] *Id.* at 15 n.61 (citing *El Paso Natural Gas Co.*, 140 FERC ¶ 61,148, at P 27 (2012)).

[775] *Id.* at 17 n.67 (citing Opinion No. 517, 139 FERC ¶ 61,095 at P 329).

[776] *Id.* at 17-18.

[777] Texas Gas Service Brief Opposing Exceptions at 22.

new contract set).[778] Rate Protected Shippers/ACC argue that APS' contention that "[t]here is no record in Docket No. RP10-1398 regarding the appropriate methodology for implementing a [Article 11.2(b)] remedy" is wrong. Rate Protected Shippers/ACC argue that the detailed Article 11.2(b) testimony (and related cross examination) presented in the instant proceeding but struck by the Presiding Judge, was specifically allowed to remain in the record as offers of proof, and provide the Commission a complete record on this issue in this docket.[779] Texas Gas Service disagrees with APS that the Commission can resolve the issue based on the prior record in the 2008 Rate Case since there was a settlement defining the implementation of the Article 11.2(b) remedy in that case and there is no settlement for the 2011 Rate Case.[780] Rate Protected Shippers/ACC argue that APS was not denied an opportunity to present a full case on the Article 11.2(b) remedy in this case as all intervenors were privy to the same facts and some, such as Rate Protected Shippers, chose to make full evidentiary presentations on Article 11.2(b) remedies issues in this docket while others did not.[781] Texas Gas Service further argues that, because the remedy testimony is available for the Commission's consideration, establishing a separate proceeding to determine the remedy is unnecessary, and inappropriately rewards the parties that failed to address this issue in the hearing.[782] Rate Protected Shippers/ACC ask the Commission to reject APS' proposal to develop an Article 11.2(b) remedy in this proceeding based on the record in the 2008 Rate Case.[783]

519. Rate Protected Shippers/ACC urge the Commission to find, based on its rulings in Opinion No. 517 and the facts of this case, that El Paso was 614,139 Dth/d short of meeting the Article 11.2(b) presumption.[784] Rate Protected Shippers/ACC argue that the proper data to use for the Article 11.2(b) presumption is the actual test period contracted capacity data included in Ex. EPG-439, "Article 11.2(b) Presumption Analysis Using Maximum Rate Equivalents and CRNs, Updated for Test Period Actuals,"[785] recognizing

[778] *Id.* at 24-25.

[779] Rate Protected Shippers/ACC Brief Opposing Exceptions at 19.

[780] Texas Gas Service Brief Opposing Exceptions at 25.

[781] Rate Protected Shippers/ACC Brief Opposing Exceptions at 22.

[782] Texas Gas Service Brief Opposing Exceptions at 25-26.

[783] Rate Protected Shippers/ACC Brief Opposing Exceptions at 23.

[784] *Id.* at 23 n.87.

[785] *Id.* at 23 n.88 (citing Rate Protected Shippers Brief on Exceptions, App. A).

that the Commission's regulations prefer the use of actual test period data, where available. Rate Protected Shippers/ACC argue that Trial Staff presented a series of well-reasoned arguments opposing El Paso's use of normalized/annualized last day of the test period contract data for purposes of calculating reservation billing determinants for purposes of calculating El Paso's Article 11.2(b) presumption shortfall.[786]

Commission Determination

520. While the Commission agrees with the Presiding Judge that Opinion No. 517 established an analytic framework to determine whether El Paso has met the Article 11.2(b) presumption, the Commission disagrees with the Presiding Judge's finding that the Commission's framework in Opinion No. 517 makes the issue here moot. As the Commission stated in Opinion No. 517, the analysis begins with a calculation of whether El Paso's firm contracts at or above the rate cap exceed 4,000 MMcf/d. Because El Paso's sales volumes have changed as reflected in the testimony submitted in the current proceeding, the determination whether El Paso's firm contracts exceed 4,000 MMcf/d must be made based on a calculation using current data, that is, the more current data developed at hearing. Applying the analytic framework that the Commission used in Opinion No. 517, the Commission finds that El Paso has failed to demonstrate that it met the 4,000 MMcf/d presumption. However, the Commission lacks sufficient data to determine whether the costs of 1995 capacity are being charged to customers that are protected under Article 11.2(b) and what methodology is appropriate to ensure that Article 11.2(a) shippers do not bear the cost of unsubscribed or discounted 1995 capacity through rates for non-Article 11.2(a) service.

521. Because the Presiding Judge did not address whether El Paso satisfied the Article 11.2(b) requirements, the Commission remands this issue to the Office of Administrative Law Judges to determine whether El Paso proposes to shift the costs of unsubscribed or discounted 1995 capacity to the rates of Article 11.2(b) shippers, and, if so, how to determine an appropriate refund and/or otherwise ensure that Article 11.2(a) shippers do not bear the cost of unsubscribed or discounted 1995 capacity through rates for non-Article 11.2(a) service.

522. Article 11.2(b) prohibits El Paso from including the cost of unsubscribed or discounted 1995 capacity in the rates of Article 11.2(b) shippers and provides that El Paso will assume full cost responsibility for those costs.[787] To simplify a

[786] *Id.* at 24 n.93 (citing Trial Staff Brief on Exceptions at 92-97).

[787] Article 11.2(b) of the 1996 Settlement provides that "El Paso assumes full cost responsibility for any and all existing and future step-downs or terminations and the associated CD/billing determinants related to the capacity describe in this subparagraph (b)."

determination of whether Article 11.2(b) is satisfied, the Commission established a presumption that "if El Paso has 4,000 MMcf/d of firm capacity subscribed at the rate cap level or above, there will be a presumption that there is no 1995 stranded or discounted capacity."

523. Determining whether El Paso met the requirements of Article 11.2(b) has been complicated by the overlapping nature of the two rate cases. The issue was fully litigated in the 2008 Rate Case resulting in a determination in Opinion No. 517 that, based on the record in that proceeding, El Paso had met the Article 11.2(b) requirements because it had contracts for at least 4,000 MMcf/d of capacity subscribed at or above the Article 11.2(a) rates. In reaching that determination, the Commission found that the firm contracts that count toward the 4,000 MMcf/d presumption include short-term firm, backhaul, short haul, east flow, and production area contracts. Opinion No. 517 further found that it is reasonable to include CRNs associated with El Paso's premium hourly services, but that it is not reasonable to include discount contracts priced below the Article 11.2(a) rates or the maximum rate equivalent of those discounted contracts.[788]

524. When the Commission set the instant case for hearing, it acknowledged that Article 11.2 issues were part of both proceedings and stated that the then-upcoming initial decision in the 2008 Rate Case would give the Commission the opportunity to base its decision on a completed hearing record. As a result, the Commission stated that identical issues were not to be re-litigated in the instant proceeding.[789] Because the hearing phase of the instant proceeding concluded before Opinion No. 517 was issued, the parties in this proceeding could not factor in the Commission's determinations regarding compliance with Article 11.2(b) until the briefs on and opposing exceptions.

525. The Commission finds that, when the Opinion No. 517 determinations are applied to the facts in this proceeding, El Paso does not meet the 4,000 MMcf/d (or 4,068,000 Dth/d) presumption to satisfy the Article 11.2(b) requirements.[790] El Paso's Ex. EPG-439 demonstrates that (1) El Paso's long-term and short-term capacity sold at or above the Article 11.2(a) rate is 2,481,552 Dth/d; (2) Article 11.2(a) contact capacity is 612,152 Dth/d; and (3) CRNs are 360,157 Dth/d.[791] El Paso's Ex. EPG-439 also adds 992,560

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[788] Opinion No. 517, 139 FERC ¶ 61,095 at PP 323-330.

[789] *2011 Rate Case Suspension Rehearing,* 133 FERC ¶ 61,253 at P 16.

[790] Capacity amounts (measured in million cubic feet, MMcf) are converted to dekatherm (Dth) equivalents using the system conversion factor of 1.017 Dth per MMcf.

[791] *See* Ex. EPG-439 (an updated version of Ex. EPG-401 using actual end of test period contract data).

Dth/d (the maximum rate equivalent of El Paso's long-term and short-term firm discounted contracts) for a total of 4,372,095 Dth/d. Opinion No. 517, however, determined that the maximum rate equivalent of discounted contracts was not to be counted toward the presumption. Thus, the total capacity at or above the Article 11.2(a) rate that can be counted toward the 4,068,000 Dth/d presumption is 3,453,861 Dth/d, which is 614,139 Dth/d short of the presumption.

526. Although El Paso provides revenue and contract volume data by rate schedule in an attempt to demonstrate that its comparable revenues, if not the actual contract volumes, exceed those to be supported under the 4,000 MMcf/d presumption,[792] this showing lacks sufficient detail to determine what 1995 capacity costs are being recovered, and whether any such costs are being charged to Article 11.2(a) shippers through non-Article 11.2 contract rates.

527. Opinion No. 517 clarified that the presumption was established to simplify compliance with Article 11.2(b) but is not the only method for determining compliance with Article 11.2(b). The Commission stated that "[i]f the presumption is not met, other evidence might show that Article 11.2(b) is otherwise satisfied."[793] El Paso offered such other evidence in the form of two analyses: a peak day analysis and a revenue analysis. As discussed below, neither analysis is sufficient to establish that El Paso satisfies the Article 11.2(b) requirement.

528. Under El Paso's peak day method, El Paso annualizes the maximum daily quantity for the peak month of all firm contracts. El Paso purports that the evidence shows that it has significantly more than 4,000 MMcf/d under contract at the Article 11.2(a) rate cap level or above using this peak day approach without including discounted contracts below the Article 11.2(a) rate. El Paso argues that the peak day capacity analysis is justified by the fact that certain contracts have sculpted (i.e., variable) maximum monthly capacity commitments during a year. El Paso argues that it must ensure that it has available capacity for each shipper's peak month, not the smaller off-peak month levels. El Paso further notes that the Commission recognized that sculpted MDQs "pose difficulties to El Paso in managing and contracting for off-peak capacity that has no associated peak capacity."[794] El Paso argues that because a major effect of sculpting is to suppress El Paso's annual average capacity subscription levels, the use of the peak day method to

[792] Ex. EPG-439.

[793] Opinion No. 517, 139 FERC ¶ 61,095 at P 323.

[794] El Paso Brief on Exceptions at 140 (citing Opinion No. 517, 139 FERC ¶ 61,095 at PP 104-105, which cites to *El Paso Natural Gas Co.*, 125 FERC ¶ 61,309 at P 162 (order on 2006 Rate Case technical issues)).

satisfy the Article 11.2(b) requirements is necessary to avoid penalizing El Paso for the impact of unorthodox sculpted contracts.

529. El Paso's peak day analysis is flawed in that it ignores the fact that the sculpted contracts allow certain of the sculpted contract shippers' peak month quantities to offset each other. In fact, sculpted contracts were implemented in the Capacity Allocation Proceeding for that reason, to enable El Paso to provide reliable firm service to its shippers at their historic contract levels during a period of constrained capacity because El Paso's shippers did not all have peak demand in the same months.[795] While El Paso's system is no longer constrained, and its contract set has changed in the 10 years since the Capacity Allocation Proceeding, the fact remains that a number of the sculpted contracts have peak demands that offset each other. A review of Ex. EPG-402 shows that certain shippers have peak months during the winter months (e.g. New Mexico Gas, SoCal Gas, Southwest Gas, Texas Gas Service, and UNS) while certain others have peak months during the summer months (e.g., APS, El Paso Electric, Freeport, Gila River, New Harquahala, Southwestern, and Tucson Electric).[796] While a variety of factors may affect the offsetting benefits of these contracts (such as location of receipt and delivery points for the sculpted contracts), El Paso has not demonstrated that these peak month contracts do not offset each other such that it is therefore reasonable to annualize the peak month quantities to satisfy the Article 11.2(b) requirement.

530. El Paso's revenue analysis is also flawed. El Paso compares its total revenues (from all contracts) with its 1995 facility costs to demonstrate that its revenues exceed the 1995 costs. El Paso argues that its 1995 costs, as measured by the net plant cost of its 1995 facilities, are about $246.5 million, compared with total revenues of over $500 million. El Paso notes that even if one conservatively adds El Paso's entire post-1995 maintenance and pipeline safety expenses to the 1995 costs, the total revenues still exceed the costs.[797] El Paso's revenue analysis fails to acknowledge, however, that a substantial portion of the non-Article 11.2(a) contract revenues are discount rate contracts for which El Paso is seeking a discount adjustment. Earlier in this opinion, the Commission approved El Paso's proposed discount adjustment. As a result, the Article 11.2(a) shippers that also hold maximum recourse rate contracts will be paying a share of that discount adjustment. If El Paso proposes to count those discounted contract revenues to support compliance with Article 11.2(b), then it must demonstrate that the discounted

[795] *Capacity Allocation Clarification Order*, 100 FERC ¶ 61,285 at PP 33-34.

[796] *See e.g.*, Ex. EPG-402, lines 5, 33, 40, 42, 55, 57-59, 70-73, 77-78, 80, 84.

[797] El Paso Brief on Exceptions at 142 n.185 (comparing Ex. EPG-62 and Ex. EPG-244; also Ex. EPG-231).

amounts are sufficient to ensure that Article 11.2(b) shippers are not being allocated costs attributable to discounted or unsubscribed 1995 capacity. Otherwise, it appears that the Article 11.2(a) shippers may be asked to bear the cost of discounted 1995 capacity in violation of Article 11.2(b).

531. Because El Paso has failed to demonstrate that it satisfies the Article 11.2(b) requirements, it remains necessary to determine an appropriate means to ensure that Article 11.2(a) shippers do not bear the cost of unsubscribed or discounted 1995 capacity through the rates that Article 11.2(a) shippers pay for other non-Article 11.2(a) service. Rate Protected Shippers, Texas Gas Service, and APS proposed methods to calculate such a remedy; however, the Presiding Judge struck this testimony, except as offers of proof for exceptions. As a result, parties have not had an adequate opportunity to address the underlying issues, and there is an insufficient record for the Commission to make a determination. Because the current record is incomplete, the Commission remands this issue to the Office of Administrative Law Judges for a Supplemental Hearing.

532. In this Opinion, the Commission finds that El Paso has failed to meet the 4,000 MMcf/d threshold to demonstrate that sufficient capacity is subscribed at rates above the 1996 Settlement rate cap, such that the additional rate protections in Article 11.2(b) are not triggered. Article 11.2(b) states:

> El Paso agrees that the firm rates applicable to service to any Shipper to which this paragraph 11.2 applies will exclude any cost, charge, surcharge, component, or add-on in any way related to the capacity of its system on December 31, 1995, to deliver gas on a forward haul basis to the Shippers listed on *Pro Forma* Tariff Sheet Nos. 33-35, that becomes unsubscribed or is subscribed at less than the maximum applicable tariff rate as escalated pursuant to paragraph 3.2(b). El Paso assumes full cost responsibility for any and all existing and future step-downs or terminations and the associated CD/billing determinants related to the capacity described in this subparagraph (b).

533. Elsewhere in this proceeding, the Commission approves billing determinants adjusted to reflect a discount adjustment for rates that may be subscribed at less than the recourse rates. The discount adjustment will allocate additional costs for maximum rate contracts, and some portion of these costs may represent costs of 1995 capacity used to serve the discounted contracts. To the extent that shippers hold contracts protected by Article 11.2(b), their rates should not incorporate costs of unsubscribed or discounted 1995 capacity (through the discount adjustment or otherwise). The hearing should determine what portion of the recourse rates represents costs of 1995 capacity covered by

Article 11.2(b) and develop an appropriate rate for these contracts which excludes such costs.

534. To address the various findings in this order, El Paso is required to file *pro forma* recalculated rates consistent with the Commission's holdings herein, as discussed later in this order. That compliance filing should reflect the Commission's findings here with regard to Article 11.2. These include the use of a single cost of service instead of El Paso's proposed bifurcated cost of service, a single billing determinant data set for the 12-month period ending March 31, 2011 and the approved rate design, all as discussed elsewhere in this order. There is no issue in this proceeding as to the rates applicable to Article 11.2(a) contracts, which are set by the 1996 Settlement. However, the Commission finds that El Paso, under the terms of the 1996 Settlement, assumed the full responsibility of the costs associated with the Article 11.2(a) rates and has not supported reallocation to other customers of the Article 11.2(a) rate differential under the settlement. Therefore, under the billing adjustment methodology the Commission approves above, there should not be an adjustment to transfer the costs not recovered from the Article 11.2(a) rates to other El Paso shippers.

535. The Commission expects the parties in the remanded proceeding to use El Paso's compliance filing as the basis from which to determine the appropriate level of costs reflected in contracts protected under Article 11.2(b) for which El Paso has agreed to assume responsibility and the adjusted rates applicable to those contracts. Issues related to whether El Paso's compliance filing is in compliance with this order are not among the issues remanded to the Presiding Judge. Parties are reminded that the Commission expects spread sheets to be in electronic format, to include formulas, and to be part of the record.[798]

536. Further, this remanded proceeding is only for the resolution of the issue of El Paso's assumption of cost responsibility associated with Article 11.2(b) contracts and the determination of rates applicable to Article 11.2(b) contracts. Thus, no issues related to the recourse rates applicable to contracts or services not subject to Article 11.2(b) are remanded to the Presiding Judge. In addition, issues regarding whether El Paso has met the 4,000 MMcf/d presumption, or otherwise satisfied the Article 11.2(b) requirements are not to be relitigated.

537. Given the limited scope of the Supplemental Hearing to examine issues concerning the application of Article 11.2(b), the parties' familiarity with the issues, and the parties' existing offers of proof concerning these issues, the Commission anticipates

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[798] *Filing Via the Internet*, Order No. 703, FERC Stats. & Regs. ¶ 31,259, at PP 25-26 (2007). *See also Tennessee Gas Pipeline Co*., 133 FERC ¶ 61,266, at P 38 (2010).

that such factors will be taken into account in setting the procedural schedule.[799] In addition, in light of the parties' successful efforts in the past to resolve issues concerning potential refunds under Article 11.2(b), the Commission encourages the parties to develop a remedy through negotiation and settlement, as done in the 2008 Rate Case Settlement, although on a conditional basis.[800] Any approved proposal should identify which shippers and service agreements are eligible for Article 11.2(b) protection, consistent with our discussion of the successor-in-interest issue which follows.

F. Successor in interest (Stipulated Issue IX.H)

538. Under the terms of the 1996 Settlement, shippers that hold Article 11.2(a) contracts receive certain rate protections under Article 11.2(b). Article 11.2(b) provides that El Paso may not shift to these shippers any costs related to 1995 capacity that becomes unsubscribed or discounted below the Article 11.2(a) rates. Whereas the Article 11.2(a) rate protections are contract specific, applying only to contracts that were in effect on December 31, 1995, and that remain in effect, Article 11.2(b) is shipper specific. The Article 11.2(b) rate protections apply to all firm, forward haul contracts held by an Article 11.2(a) shipper, including non-Article 11.2(a) contracts.[801] Thus, Article 11.2(b) provides that El Paso may not shift costs to any contracts held by an Article 11.2(a) shipper, including an unlimited number of non-Article 11.2(a) contracts.

539. Burlington Resources Inc. held a relatively small (42,000 Dth/d) Article 11.2(a) contract with El Paso when it was acquired by ConocoPhillips in 2006.[802] Although ConocoPhillips had not itself been an Article 11.2 shipper, an issue arose in the 2008 Rate Case concerning whether ConocoPhillips' much larger separate contracts and any future contracts became eligible for Article 11.2(b) protections by virtue of a prior

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[799] *See* Summary of Procedural Time Standards for Hearing Cases, http://www.ferc.gov/legal/admin-lit/time-sum.asp.

[800] In the 2008 Rate Case Settlement filed March 11, 2010 in Docket No. RP08-426-000, the parties agreed to a retroactive adjustment to reservation rates if the Commission found that Article 11.2(b) was triggered. While not binding in this proceeding, the agreement demonstrates the parties' familiarity with the underlying rate issues and shows an ability to develop a workable solution. The Commission encourages the parties to negotiate and pursue an agreeable solution in this proceeding.

[801] *March 20 Order*, 114 FERC ¶ 61,290 at P 38 ("The Commission finds that Article 11.2(b) is not limited to TSAs that were in effect on December 31, 1995, but applies to all rates for all firm forward haul services provided to eligible shippers.").

[802] ID, 139 FERC ¶ 63,020 at P 306 (citing Ex. EPG-211 at 49-50).

Commission ruling that *all* firm contracts held by an Article 11.2(a) shipper were subject to Article 11.2(b).[803] Although the initial decision in the 2008 Rate Case addressed this issue on the merits, Opinion No. 517 stated that because the Commission found that Article 11.2(b) "was not triggered" in that proceeding, the subsidiary issue as to the rights of shippers that acquire Article 11.2 contracts was moot.[804]

540. El Paso cites the ConocoPhillips acquisition, as well as the circumstance that other El Paso shippers have become successors in interest to Article 11.2(a) contracts, as grounds for the Commission to determine in this case the conditions under which Article 11.2(b) protections may be extended to contracts which did not previously have them. El Paso proposes that the Commission adopt a procedure under which a successor in interest to an Article 11.2(a) contract immediately would enjoy Article 11.2(a) protections for that contract and Article 11.2(b) protections for the Article 11.2(b) contracts held by the predecessor in interest before the acquisition, but would be required to seek Commission concurrence before receiving Article 11.2(b) protections for any contracts other than those that qualified in the absence of the succession. In other words, a successor in interest would not automatically receive Article 11.2(b) protections for the remainder of its (non-Article 11.2) El Paso contract portfolio.[805]

541. UNS/Tucson Electric, Rate Protected Shippers[806] and Texas Gas Service oppose El Paso's proposal as unnecessary, unjust and unreasonable, and inconsistent with Article 11.2, prior Commission orders, and the Presiding Judge's October 20, 2011 ruling based on the initial decision in the 2008 Rate Case.[807]

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[803] *March 20 Order*, 114 FERC ¶ 61,290 at PP 56-58.

[804] Opinion No. 517, 139 FERC ¶ 61,095 at P 331.

[805] *See* Ex. EPG-404 at 24.

[806] RPS adopts and joins in the UNS/Tucson Electric position on this issue. Rate Protected Shipper Initial Brief at 50.

[807] ID, 139 FERC ¶ 63,020 at P 308 n.275 (stating "The October 20, 2011 oral ruling (on a motion to strike pre-filed testimony) was based on the [*2011 Rate Case Suspension Order*] admonition to preclude re-litigating issues addressed in [the 2008 Rate Case], and my understanding of the issue addressed in the Initial Decision from that proceeding. Tr. 292-98. Based on my current understanding of the issue presented in *this* proceeding, the October 20, 2011 ruling was simply wrong.").

Initial Decision

542. The Presiding Judge found as a threshold matter that Article 11.2(b) is "triggered" in this proceeding and must be addressed insofar as Article 11.2(a) contract assignments/assumptions are claimed to expand Article 11.2(b) protections. The Presiding Judge found that both the ConocoPhillips acquisition of Burlington, and the fact that at least four other El Paso shippers have become successors in interest to Article 11.2(a) contracts, confirm that the expansion of Article 11.2 contract protections to contracts that did not previously enjoy them is not a speculative concern here.[808] The Presiding Judge noted that El Paso states it is willing to accept the Article 11.2(b) protections ConocoPhillips, UNS, Texas Gas Service, Southwest Gas and New Mexico Gas already claim by virtue of their Article 11.2(a) contact assumptions to date.[809] Accordingly, the Presiding Judge found the El Paso proposal does not impair any "vested" Article 11.2(b) rights these entities may claim. El Paso nevertheless suggests "it may be advisable for [ConocoPhillips, UNS, Texas Gas Service, Southwest Gas and New Mexico Gas] to make a presentation to the Commission as a protective matter[]" to preclude third party challenges. The Presiding Judge stated, however, that he sees no need for any of those successors in interest to make a presentation to the Commission as a protective matter, as proposed by El Paso, and found that it should not be *required* of them in any event.[810]

543. The Presiding Judge stated that the *March 20 Order* arguably may be interpreted to suggest Article 11.2(b) protections may be extended *without limitation* to non-Article 11.2 contracts simply by virtue of an entity acquiring Article 11.2(a) rights either (i) through direct contract assignment or (ii) by acquiring an entity holding an Article 11.2(a) contract—i.e., by assumption. This interpretation is predicated on Article 11.2 rights being *shipper*-specific rather than contract (TSA)-specific.[811] The Presiding Judge stated that this makes sense insofar as shippers/TSAs implicated in the 1996 Settlement are concerned, but it is nonsensical, however, to extend the shipper-specific rationale to shippers and TSAs that were not originally implicated in the 1996 Settlement. According

[808] *Id.* P 309 n.277 (the Presiding Judge states that "[t]he instant analysis should not be construed as criticizing the [*March 20 Order*,] the [2008 Rate Case] Initial Decision or [Opinion No. 517]. The record developed in the instant proceeding is much different than the one developed in Docket No. RP08-426-000. My analysis is based on the record before me").

[809] *Id.* P 309 n.276 (citing Ex. EPG-211 at 51, 53).

[810] *Id.*

[811] *Id.* P 310 (citing *March 20 Order,* 114 FERC ¶ 61,290 at P 57).

to the Presiding Judge, ConocoPhillips' 2006 Burlington acquisition illustrates the point.[812] The Presiding Judge explained that the record indicates Burlington held only a 42,000 Dth/d Article 11.2(a) contract when ConocoPhillips acquired it in 2006 and that ConocoPhillips itself held no other Article 11.2 contracts at the time or prior to 2006.[813] When ConocoPhillips acquired Burlington and assumed its relatively small Article 11.2(a) contract, it relied on that single contract to claim Article 11.2(b) protections for its entire El Paso portfolio, none of which otherwise was covered by Article 11.2. The Presiding Judge concluded that this result is perverse and that it strains credibility to conclude it was contemplated in the 1996 Settlement.[814] The Presiding Judge found that it makes more sense to interpret the shipper-specific language in the *March 20 Order* as directed to shippers/TSAs *implicated* in the 1996 Settlement. Otherwise, any entity acquiring or succeeding to an Article 11.2(a) TSA—no matter when or how insignificant—could leverage that contract to secure Article 11.2(b) protections for its entire El Paso portfolio—no matter how large.[815] The Presiding Judge found that this would be unjust, unreasonable and unduly discriminatory. It also would compound the already robust controversies surrounding Article 11.2 rate impacts and other financial implications by exacerbating them. The Presiding Judge found that El Paso's proposal for the Commission to adopt a procedure under which any successor in interest to an Article 11.2(a) contract immediately would enjoy Article 11.2(a) protections for that contract, but would be required to seek Commission concurrence before receiving Article 11.2(b) protections for the remainder of its (non-Article 11.2) El Paso contract portfolio would be a just and reasonable response.[816] The Presiding Judge stated that a more efficient, less administratively burdensome procedure would be for the Commission

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[812] *Id.* P 310 n.278. Although the Presiding Judge stated that he used the ConocoPhillips example *exclusively* for illustrative purposes and considered the issue resolved, because El Paso accepted the Article 11.2(b) protections ConocoPhillips claims, El Paso disputes its acquiescence, stating that it was not relitigating the issue in light of the concurrent proceeding in the 2008 Rate Case, as discussed below.

[813] *Id.* P 310 (citing Ex. EPG-211 at 49-50). The Presiding Judge noted that ConocoPhillips was a party to the 1996 Settlement, but did not have any Article 11.2 contracts. Ex. EPG-211 at 50.

[814] ID, 139 FERC ¶ 63,020 at P 310.

[815] *Id.* P 310 n.280 (stating "I infer this is one reason [El Paso] proposes to add a "financially indifferent" condition to the tariff provision addressing assignments;" (citing discussion of Stipulated Issue X.D)).

[816] *Id.* P 310.

simply to establish a rebuttable presumption against Article 11.2 protections for the remainder of the portfolio whenever an Article 11.2(a) contract is assumed.

Briefs on Exceptions

544. El Paso and Competitive Power Suppliers oppose the expansion of Article 11.2(b) rights to ConocoPhillips. The Competitive Power Suppliers claim that both it and El Paso have vigorously opposed the expansion of Article 11.2 preferences to ConocoPhillips.[817] As the Competitive Power Suppliers argued, if the class of shippers eligible for the Article 11.2 rate preferences could grow beyond the original parties to the 1996 Settlement that contracted for firm capacity, the Competitive Power Suppliers and similarly-situated shippers would be placed in an unduly discriminatory position vis-à-vis an ever larger growing class of Article 11.2 shippers and contracts. The Competitive Power Suppliers support the Article 11.2 eligibility standards proposed by El Paso for successors to Article 11.2(a) contracts and request that if Article 11.2 is not overturned, the benefits of Article 11.2 should only be granted to the signatories of the 1996 Settlement that, before 1996, entered into and have retained firm transportation agreements and not to any of their successors.[818]

545. El Paso agrees with the Presiding Judge's findings that (1) ConocoPhillips' ability to claim Article 11.2(b) protection for its entire El Paso portfolio would be a "perverse" result; (2) El Paso's proposed procedures are just and reasonable; and (3) the Commission should establish a rebuttable presumption against Article 11.2 protections for the remainder of the shipper's portfolio whenever an Article 11.2(a) contract is assumed.[819] El Paso argues, however, that the Presiding Judge's statement that El Paso "is willing to accept the Article 11.2(b) protections" for ConocoPhillips, UNS, Texas Gas Service, Southwest Gas, and New Mexico Gas are incorrect as to ConocoPhillips and overbroad as to the other parties.[820] El Paso states that it actively contested ConocoPhillips' Article 11.2(b) eligibility in the 2008 Rate Case and that its testimony and briefs in this case make clear that it was not litigating the status of ConocoPhillips in the instant docket because it believed, based on the Commission's warning against relitigation, that the issue would be decided on the merits in the 2008 Rate Case, and could not be relitigated here. El Paso notes that the Commission did not decide the successor-in-interest issue on the merits in Opinion No. 517, and urges the Commission

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[817] Competitive Power Suppliers Brief on Exceptions at 19.

[818] *Id.* at 20.

[819] El Paso Brief on Exceptions at 144-45.

[820] *Id.* at 145 (citing ID, 139 FERC ¶ 63,020 at P 309 n.276, P 310 n.278).

to adopt the Presiding Judge's findings in this case for that issue. El Paso submits that the Commission should adopt its proposed procedure or, alternatively, the Presiding Judge's rebuttable presumption, to address any future assignments, acquisitions or similar transactions that would create a similar successor-in-interest issue.[821]

546. New Mexico Gas, Texas Gas Service, and UNS/Tucson Electric state that the Presiding Judge erred in limiting rate protection to TSAs implicated by the 1996 Settlement, contrary to the Commission's prior ruling in the *March 20 Order*.[822] New Mexico Gas states that the Commission previously considered the eligibility of Article 11.2(b) rate protection for new firm services proposed by El Paso and rejected El Paso's interpretation of Article 11.2, finding "that Article 11.2(b) is not limited to TSAs that were in effect on December 31, 1995, but applies to rates for all firm forward haul services provided to eligible shippers."[823] New Mexico Gas argues that the Commission found that El Paso's attempt to narrow the interpretation of Article 11.2(b) could not be reconciled with the broad language in Article 11.2(b).[824] UNS/Tucson Electric argue that El Paso's proposed procedures are unnecessary because the Commission has already ruled in its *March 20 Order* who is eligible for Article 11.2(b) protections.[825]

547. Texas Gas Service argues that El Paso has asked for a broad ruling on the applicability of Article 11.2 for a successor in interest to an Article 11.2 contract which is unnecessary because El Paso does not challenge any successor in interest except ConocoPhillips', which was litigated in the 2008 Rate Case.[826]

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[821] *Id.* at 145-46.

[822] New Mexico Gas Brief on Exceptions at 7-8 Texas Gas Service Brief on Exceptions at 44-45 (citing *March 20 Order,* 114 FERC ¶ 61,290 at PP 55-58, Opinion No. 517, 139 FERC ¶ 61,095 at P 331); UNS/Tucson Electric Brief on Exceptions at 25).

[823] New Mexico Gas Brief on Exceptions at 7-8 (citing *March 20 Order*, 114 FERC ¶ 61,290 at P 56).

[824] *Id.* at 8 (citing *March 20 Order,* 114 FERC ¶ 61,290 at P 57).

[825] UNS/Tucson Electric Brief on Exceptions at 25 (citing *March 20 Order*, 114 FERC ¶ 61,290 at P 56; *see also* Ex. RPS-23).

[826] Texas Gas Service Brief on Exceptions at 40-41 (stating that its eligibility for Article 11.2(b) protections stems from being a successor-in-interest to Southern Union Gas Company's 1995-era Article 11.2(a) agreement).

548. Texas Gas Service argues El Paso's proposal is flawed because it inaccurately defines an Article 11.2 contract as "a firm contract in effect on December 31, 1995, as identified in the 1996 Settlement and that remains in effect today."[827] Texas Gas Service argues the Presiding Judge did not acknowledge Texas Gas Service's argument that El Paso's proposal asserted an overly-restrictive definition of Article 11.2, and rejection of El Paso's successor-in-interest proposal is warranted for this reason alone. Texas Gas Service argues that El Paso's inaccurate definition ignores history and the Commission's prior findings, and could serve as a basis for denying Article 11.2 protection to shippers that were forced to enter into new contracts.[828]

549. UNS/Tucson Electric and New Mexico Gas argue that the Presiding Judge's interpretation limiting Article 11.2 protection solely to shippers implicated in the 1996 Settlement amounts to a revision of the 1996 Settlement that can only be accomplished through a *Mobile-Sierra* analysis and a finding that the 1996 Settlement seriously harms the public interest.[829] New Mexico Gas and UNS/Tucson Electric assert the Presiding Judge's presumption lacks any record support or analysis showing that establishing such a presumption is necessary to prevent serious harm to the public interest and therefore fails the *Mobile-Sierra* test and must be rejected.[830]

550. New Mexico Gas argues that the Presiding Judge's proposed rebuttable presumption (1) has no support in the record, (2) is contrary to Commission policy and precedent, and (3) was not advocated by El Paso or any other party in testimony or arguments supporting such a proposal. New Mexico Gas argues that, on this basis alone, the Commission should reject the Presiding Judge's finding as unsupported. In the alternative, New Mexico Gas asserts that the Commission should reverse the holding of the Presiding Judge as in conflict with the Commission's policy favoring the ability of

[827] *Id.* at 41-42.

[828] *Id.* at 48-50.

[829] UNS/Tucson Electric Brief on Exceptions at 27 (citing *Morgan Stanley Capital Group Inc. v. Pub. Util. Dist. No. 1 of Snohomish County, Wash.*, 554 U.S. 527, 551 (2008); *see Mobile*, 350 U.S. 332; *Sierra*, 350 U.S. 348); New Mexico Gas Brief on Exceptions at 11.

[830] New Mexico Gas Brief on Exceptions at 12; UNS/Tucson Electric Brief on Exceptions at 27.

shippers to assign their contract rights and to acquire another company's contract rights through acquisition or assumption.[831]

551. Texas Gas Service states that the Presiding Judge agreed with Texas Gas Service that there is no need for current successors-in-interest to make a presentation to the Commission as a protective matter nor should it be required, but the Presiding Judge did not make the logical finding that there should also not be a need for future successors-in-interest to make such a presentation to the Commission for Article 11.2(b) protections. Texas Gas Service states El Paso's successor-in-interest proposal shifts the burden of proof to shippers in all instances, contrary to the NGA which places the burden of proof on the pipeline to show changes in rates are just and reasonable. Texas Gas Service argues that the Commission has found that Article 11.2(b) protections pertain to shippers not contracts, and the Presiding Judge's presumption will force shippers to file a section 5 complaint to receive Article 11.2(b) protections.[832]

552. Texas Gas Service argues the Commission should reject the Presiding Judge's successor-in-interest presumption as beyond the scope of this proceeding and not supported by substantial evidence. Texas Gas Service argues the Presiding Judge's presumption violated due process rights since parties first learned of the proposal in the Initial Decision and did not have an opportunity to rebut the proposal. Texas Gas Service argues that relitigating the successor-in-interest issue in the 2011 Rate Case is contrary to the Commission's ruling against relitigating identical issues and is also contrary to the principles of administrative efficiency and judicial economy by basically giving rise to the possibility of inconsistent decisions. Texas Gas Service argues that avoiding relitigation conserves Commission and party resources and would avoid the bad public policy that would result if the Commission were to make merits determinations on issues that it had previously admonished parties not to litigate.[833]

553. Texas Gas Service argues that, alternatively, in the interest of judicial economy, and in light of public policy considerations, the Commission should disregard Paragraph

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[831] *Id.* at 10-11 (citing *ANR Pipeline Co.*, 81 FERC ¶ 61,088, at 61,347 (1997) (recognizing the Commission "generally favors assignment" as long as it does not result in additional costs to the pipeline's customers); 2008 Rate Case Initial Decision, 134 FERC ¶ 63,002 at P 641 (recognizing the right to assignment under contract law under Restatement 2d of Contracts § 317)).

[832] Texas Gas Service Brief on Exceptions at 46-47 (citing 15 U.S.C. 717c (2006)).

[833] *Id.* at 50-53.

310 of the Initial Decision, address the successor-in-interest issue on rehearing or reconsideration in the 2008 Rate Case, and apply those findings to the 2011 Rate Case.[834]

Briefs Opposing Exceptions

554. El Paso claims that the Presiding Judge was correct in holding that the acquisition of a TSA that was in effect on December 31, 1995 does not entitle the successor-in-interest to Article 11.2(b) rights. El Paso states that adopting new procedures will assure that potential disputes arising from the acquisition of Article 11.2 contracts will be promptly brought to the Commission. El Paso asserts that the procedures are clearly needed, citing ConocoPhillips's continued claim to eligibility and the possibility that other Article 11.2 contracts will be acquired. In response to Texas Gas Service's contention that the presumption would unnecessarily require shippers to file a section 5 complaint to receive Article 11.2(b) protection, El Paso asserts that a shipper claiming that an acquisition of an Article 11.2(a) contract entitles it to Article 11.2(b) protection for all its contracts should bear a section 5 burden and that imposition of a rebuttable presumption in these circumstances is entirely appropriate.[835]

555. Competitive Power Suppliers argue that the Presiding Judge correctly found it nonsensical to expand Article 11.2(b) rate preferences that might someday arise under Article 11.2(b) to the full portfolio of contracts of a shipper like ConocoPhillips who would have a total of about 500,000 Dth/d of firm agreements receiving Article 11.2(b) protection as a result of its acquisition of an Article 11.2(a) 42,000 Dth/d agreement. Competitive Power Suppliers agree with the Presiding Judge's finding that this result is perverse.[836]

556. New Mexico Gas argues that El Paso did not propose or offer any evidence in this case to support a rebuttable presumption and such a limitation on a shipper's ability to assign and acquire Article 11.2(a) contracts is contrary to Commission policy that favors the ability of shippers to assign their contract rights and to acquire another company's contract rights through acquisition or assumption. New Mexico Gas argues that the Presiding Judge and El Paso did not make a showing that passes the *Mobile-Sierra* test, and that El Paso's request for additional procedures cannot be supported and should therefore be rejected.[837]

[834] *Id.* at 53.

[835] El Paso Brief Opposing Exceptions at 167-168.

[836] Competitive Power Suppliers Brief Opposing Exceptions at 20-21.

[837] New Mexico Gas Brief Opposing Exceptions at 8.

557. Texas Gas Service opposes any proposal that would force it to shoulder the burden and expense of filing a complaint with the Commission in order to preserve its right as a successor-in-interest.[838] New Mexico Gas argues that El Paso's attempt on exceptions to extend the Presiding Judge's rulings on the successor-in-interest issue to New Mexico Gas and future assignments is impermissible, without merit, and should be rejected.[839] New Mexico Gas argues that, because El Paso does not contest its eligibility for Article 11.2(b) protection, there is no reason for New Mexico Gas to seek further assurances from the Commission on the validity of its Article 11.2(b) rights; these procedures would apply prospectively and thus would not apply to New Mexico Gas because it assumed its Article 11.2(a) contracts in 2009.[840] New Mexico Gas argues that El Paso offers no reason for the Commission to reconsider the Presiding Judge's finding that shippers should not be required to undertake a voluntary presentation to the Commission to validate Article 11.2(b) rights.[841]

558. New Mexico Gas argues that El Paso failed to properly preserve an exception to New Mexico Gas's Article 11.2(b) protection rights and therefore failed to adhere to Rule 711, 18 C.F.R. § 385.711(b)(2)(ii), which states that briefs on exceptions should contain a list of numbered exceptions, including a specification of each error of fact or law asserted. New Mexico Gas states the Commission has found that a party that does not comply with the technical requirements has not raised a proper exception and has denied it.[842] New Mexico Gas states that El Paso listed the Presiding Judge's error regarding El Paso's willingness to accept the Article 11.2(b) protections for ConocoPhillips but did not list as an error the Presiding Judge's rulings on New Mexico Gas's Article 11.2(b) protections. New Mexico Gas argues that the Commission should therefore deny El Paso's arguments in its brief on exceptions asking the Commission for specific relief related to New Mexico Gas's Article 11.2(b) protection and any future assignment of New Mexico Gas's Article 11.2(a) contracts.[843]

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[838] Texas Gas Service Brief Opposing Exceptions at 27.

[839] New Mexico Gas Brief Opposing Exceptions at 5-6.

[840] *Id.* at 6-7 (citing El Paso Initial Brief at 188 n.218, which states that El Paso would not oppose a decision to make its proposal effective prospectively).

[841] *Id.* at 7-8 (citing ID, 139 FERC ¶ 63,020 at P 309 n.276).

[842] *Id.* at 11 (citing *Cal. ex rel. Lockyer v. British Columbia Power Exch. Corp.*, 135 FERC ¶ 61,113, at P 49 (2011)).

[843] *Id.* at 11-12.

559. New Mexico Gas argues that the Competitive Power Suppliers' request (to limit the class of shippers eligible for Article 11.2 benefits to the original parties to the 1996 Settlement) is a collateral attack on prior Commission orders which found that Article 11.2 rights are shipper-specific and not contract-specific and that therefore Article 11.2 benefits extend to the signatories of the 1996 Settlement that have Article 11.2(a) contracts and their successors and assignees.[844] New Mexico Gas argues that the Competitive Power Suppliers' narrow view of the class of shippers that are entitled to Article 11.2 benefits is inconsistent with El Paso's own views and El Paso's actual proposal for Article 11.2(b) eligibility in this case.[845] New Mexico Gas argues that while El Paso recognizes some successor-in-interests' rights to some Article 11.2 benefits, the Competitive Power Suppliers would deny a successor even the benefits of Article 11.2(a); New Mexico Gas asks the Commission to reject Competitive Power Suppliers' position.[846]

560. ConocoPhillips argues that the successor-in-interest issue was fully litigated in the 2008 Rate Case and that the initial decision in that proceeding evaluated the arguments presented by the parties and ruled in favor of allowing ConocoPhillips to be successor in interest to Burlington Resources, Inc. to qualify for Article 11.2(b) rate protection. ConocoPhillips states that, in Opinion No. 517, the Commission determined that ConocoPhillips' succession issue was moot because El Paso met the Article 11.2(b) threshold. ConocoPhillips states that it filed for rehearing of the Commission's determination in Opinion No. 517 that the succession issue was moot, citing Supreme Court precedent that issues likely to be repeated are an exception to the mootness rule.[847] ConocoPhillips argues that, since it would not be able to litigate the issue in the 2011 Rate Case, ConocoPhillips would be harmed if the Commission determined not to resolve the issue on the merits of the 2008 Rate Case.

561. ConocoPhillips argues that the issue that was litigated in the 2011 Rate Case was El Paso's proposal regarding procedures to govern successor-in-interest eligibility under Article 11.2, not ConocoPhillips succession issues. ConocoPhillips argues that the Presiding Judge erroneously believed the issue had been resolved between El Paso and ConocoPhillips and did not make a merits ruling on whether ConocoPhillips succeeded to Burlington's Article 11.2(b) rights, for he wrongly assumed that ConocoPhillips currently

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[844] *Id.* at 12-13.

[845] *Id.* at 13-14 (citing El Paso Initial Brief at 188-189).

[846] *Id.* at 13-14.

[847] ConocoPhillips Brief Opposing Exceptions at 2-3 (citing ID, 139 FERC ¶ 63,020 at P 331).

possessed those as vested rights. ConocoPhillips argues that El Paso is making an after-the-fact assertion that the Presiding Judge's ruling in the Initial Decision in the 2008 Rate Case should be used as a basis for deciding the ConocoPhillips issue anew, but there were no "rulings" on this issue, and no testimony or briefings; the Presiding Judge's observations were not findings of fact or law based on any evidence. ConocoPhillips argues if the Commission were to rule on the issue in the 2011 Rate Case, ConocoPhillips would be denied fundamental rights of due process because ConocoPhillips would be held to an outcome on an issue that it had no opportunity to litigate. ConocoPhillips argues that Section 19 of the NGA, 15 U.S.C. section 717r, requires that a Commission decision must be based on substantial evidence; in this case, there is no evidence or argument in the record.[848]

Commission Determination

562. The Commission affirms the Presiding Judge's finding that El Paso's proposed procedures are just and reasonable. Article 11.2(b) is shipper-specific; all contracts held by an Article 11.2(a) shipper are covered by the Article 11.2(b) protections. Over the years, a number of Article 11.2(a) shippers have been acquired by successors in interest, including Texas Gas Service, UNS, New Mexico Gas, and Southwest Gas, but these acquisitions did not raise succession issues as the new companies stepped into the shoes of the acquired company and maintained similar operations. Issues with regard to the scope of protection available under Article 11.2(b) have only arisen when ConocoPhillips became an Article 11.2(a) shipper as a result of its acquisition of Burlington's single 42,000 Dth/d Article 11.2(a) contract in 2006. ConocoPhillips was a signatory to the 1996 Settlement, but held no Article 11.2(a) contracts at that time to support Article 11.2(b) rate protection. In addition, ConocoPhillips holds non-Article 11.2(a) contracts in excess of 500,000 Dth/d that reflect a portion of capacity formerly served under original Article 11.2(a) contracts turned back to El Paso since 1995.

563. ConocoPhillips argues that its Article 11.2(a) contract entitles it, as a successor-in-interest, to Article 11.2(b) protections for all of its other contracts just as an original Article 11.2(a) shipper is entitled to Article 11.2(b) protections for its non-Article 11.2(a) contracts.[849] But the Commission finds that the language of the 1996 Settlement does not

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

[849] Article 11.2(b) states: "El Paso agrees that the firm rates applicable to service to any Shipper to which this paragraph 11.2 applies will exclude any cost, charge, surcharge, component, or add-on in any way related to the capacity of its system on December 31, 1995, to deliver gas on a forward haul basis to the Shippers listed on *Pro Forma* Tariff Sheet Nos. 33-35, that becomes unsubscribed or is subscribed at less than the maximum applicable tariff rate as escalated pursuant to paragraph 3.2(b)."

anticipate that a successor in interest could expand the number of contracts subject to Article 11.2(b) through its acquisition. The language and the circumstances that gave rise to the 1996 Settlement demonstrate that the rate protections offered to El Paso's shippers (including Article 11.2 rate protections, a ten-year rate moratorium, and the revenue-sharing provisions) were intended to establish a *quid pro quo* to the settling customers in exchange for up front risk-sharing payments. While load growth was anticipated, and has been recognized as protected under the terms of the settlement, it was not anticipated that a party would accede to rate-protected contracts and thereby obtain rate protection to a portfolio of contracts that would not otherwise qualify for such protections under the terms of the settlement. Under a reasonable reading of the 1996 Settlement, it appears that Article 11.2(a) shippers are afforded the rate protections provided by Article 11.2(b) to their non-Article 11.2(a) contracts because of their status as a risk-sharing signatory to the 1996 Settlement.[850] Successors in interest who were not part of the *quid pro quo* of the 1996 Settlement could not be expected to enjoy Article 11.2(b) rate protections in excess of those that the predecessors in interest enjoyed.[851]

564. El Paso has proposed that if a shipper succeeds to an Article 11.2(a) shipper's contract, the successor in interest would be entitled to (1) the protections of Article 11.2(a) for the Article 11.2(a) contract, and (2) the Article 11.2(b) protections for any Article 11.2(b) contracts acquired from the predecessor in interest. Absent Commission approval, any other El Paso contracts held by the successor in interest would not be considered Article 11.2(b) contracts.[852]

565. The Commission agrees with the Presiding Judge's finding that El Paso's proposal is consistent with Article 11.2 and is a just and reasonable approach to address the successor-in-interest issue. The Presiding Judge suggested that a more efficient, less administratively burdensome procedure would be to establish a rebuttable presumption against Article 11.2(b) protections for the remainder of a successor in interest's El Paso contract portfolio. The Commission disagrees. Creating a rebuttable presumption is

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[850] ID, 139 FERC ¶ 63,020 at P 310 (defending proposal "to interpret the [*March 20 Order*'s] shipper-specific language as being directed to shippers/TSAs *implicated* in the 1996 Settlement" as making more sense that ConocoPhillips' proposal).

[851] *See id*. (finding proposal to permit ConocoPhillips to claim Article 11.2(b) protections for its entire El Paso portfolio, none of which otherwise was covered by Article 11.2, based on its acquisition of Burlington small Article 11.2(a) contract, is "perverse" and that it "strains credibility" to conclude such a result was contemplated in the 1996 Settlement).

[852] Ex. EPG-404 at 24.

itself problematic and beyond the scope of the stipulated issue. A rebuttable presumption is unnecessary because the individual facts surrounding each successor in interest must be examined and assessed in the context of a reasonable interpretation of the Article 11.2(b) bargain. Because each succession is unique as to whether and how many contracts were implicated at the time of the predecessor in interest's bargain, the ultimate decision about scope of a successor's Article 11.2(b) protection needs to be made on a case-by-case basis.

566. As the Commission understands the circumstances of the existing successors in interest holding Article 11.2(a) contracts, it appears that Texas Gas Service, UNS, and New Mexico Gas do not hold non-Article 11.2(a) contracts that would expand the Article 11.2(b) protections beyond the contracts acquired from the predecessors-in-interest. Thus, as the Commission interprets the 1996 Settlement, these successors in interest would continue to enjoy Article 11.2(b) rate protection for their El Paso portfolios. El Paso has not objected to the Article 11.2(b) status of these successors in interest and, under El Paso's proposal, their Article 11.2(b) status would not be changed. Such an outcome is consistent with a reasonable reading of the 1996 Settlement and shippers' ability to assign contracts under contract law. The Commission agrees with the Presiding Judge's finding that these shippers need not file anything to preserve this status.

567. The Commission further agrees with the Presiding Judge's conclusion that, although the Article 11.2(b) protections have been interpreted by some to extend *without limitation* to non-Article 11.2 contracts simply by virtue of an entity's acquiring Article 11.2(a) rights, this is not the Commission's interpretation of the 1996 Settlement, and it would be unjust, unreasonable, unduly discriminatory, and contrary to the public interest to allow such an interpretation whereby an acquiring shipper could leverage its acquired Article 11.2(a) contract to secure Article 11.2(b) protections for a very large El Paso contract portfolio that would not otherwise be covered by Article 11.2(b). It is reasonable to conclude that such a result was not contemplated by the 1996 Settlement.[853]

568. The issue before the Presiding Judge was limited to whether El Paso's proposal to establish procedures governing successor-in-interest eligibility under Article 11.2 was just and reasonable. Because of the timing issues of this proceeding and the 2008 Rate Case proceeding, the related issue of ConocoPhillips' eligibility had not been resolved. In Opinion No. 517, the Commission determined that the issue was moot because El Paso

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[853] Restatement Contracts, 2d, § 203(a) (1981); *AEP Generating Co.*, 39 FERC ¶ 61,158, at 61,626 (1987) ("It is also a well-settled principle of law that agreements and tariffs are to be given a reasonable construction over one which results in unfair, unusual, absurd, or improbable results," (citing *Penn Central Co. v. General Mills, Inc.*, 439 F.2d 1338 (8th Cir. 1971))).

had met the 4,000 MMcf/d Article 11.2(b) presumption and Article 11.2(b) thus had not been triggered. Earlier in this opinion, the Commission finds that El Paso has not met the Article 11.2(b) presumption here and, therefore, ConocoPhillips' eligibility is now ripe for review. Based on the record in the two proceedings, the Commission finds that Article 11.2(b) does not apply to the non-Article 11.2(a) contracts in ConocoPhillips' El Paso portfolio that would not otherwise be eligible for Article 11.2(b) protection. Those non-Article 11.2(a) contracts reflect a portion of the original Article 11.2(a) contracts turned back to El Paso since 1995.[854] As such, they were not Article 11.2(b) contracts at the time they were acquired by ConocoPhillips.

569. These facts contradict the circumstances contemplated in the presiding judge's analysis in the 2008 Rate Case, where the judge noted that "[a] shipper would have to terminate all of its eligible TSAs to affect eligibility of future TSAs acquired by the eligible shipper."[855] Consequently, the 2008 Rate Case analysis does not appear to contemplate a shipper re-acquiring Article 11.2(a) eligibility, because the record there does not address the fact that ConocoPhillips had no such rights for its portfolio in 1996, when the settlement was executed, until it acquired the Burlington interest in 2006. Consequently, despite the disparate determinations in the two dockets, the Commission finds that the Presiding Judge in this proceeding provided a just and reasonable interpretation of Article 11.2, and the Commission affirms his disposition of the successor-in-interest issue, as discussed herein.

IX. Capital Structure

A. Debt Ratio (Net Proceeds or Gross Proceeds Method) (Stipulated Issue II.B)

570. El Paso and Trial Staff disagree on what the appropriate method is to calculate the debt ratio in the capital structure. El Paso argues that unless the net proceeds method is used, which includes debt issuance costs in the rate base, it will be unable to recover its full cost of capital. In this regard, El Paso maintains that the record evidence shows the need for a fundamental change in the Commission-established methodology. Trial Staff, on the other hand, contends that both Commission regulations and precedent require that the gross proceeds method be used. Moreover, Trial Staff alleges that the net proceeds method produces an "illegitimate" after-tax weighted cost of capital because it

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[854] ConocoPhillips Reply Brief in Docket No. RP08-426-000 at 9.

[855] 2008 Rate Case Initial Decision, 134 FERC ¶ 63,002 at P 641.

understates debt and overstates equity. The Presiding Judge rejected El Paso's arguments and held that the debt ratio must be computed on a gross proceeds basis.[856]

Initial Decision

571. The Presiding Judge pointed out that El Paso acknowledges that Commission policy precludes debt issuance costs from being included in rate base:

> When pipelines realize gains from refinancing debt, the Commission does not require the pipeline to reduce its rate base by the amount of the gains. Similarly, pipelines are not permitted to recover carrying charges when they incur costs to refinance the debt.[857]

572. El Paso also recognizes that the Commission rejected a previous proposal to compute debt ratio using a net proceeds methodology. The Presiding Judge noted the Commission's general policy:

> [W]e reject SERI's proposal to compute the long-term *debt ratio* by using the net proceeds of debt (*i.e.*, gross proceeds less unamortized premium, discount, expenses, and losses) instead of the gross proceeds of debt. SERI argues that the gross proceeds should not be used in the capital structure because it includes unamortized debt issuance costs and premium expenses that are not available to invest in rate base. Thus, SERI claims that the net proceeds, which excludes these costs, should be used instead. We disagree. It is the gross proceeds of a company's long-term debt, *i.e.*, the total principal outstanding, that belong in the capital structure because this reflects the company's total obligation with respect to long-term debt.[858]

573. El Paso nevertheless argued that using gross proceeds prevents it from recovering its full cost of capital and submitted a detailed theoretical model purporting to

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[856] ID, 139 FERC ¶ 63,020 at PP 64-69.

[857] *Id.* P 66 (citing *Northwest Pipeline Corp.*, 71 FERC ¶ 61,253, at 61,996 (1995)).

[858] *Id.* P 67 (citing *System Energy Resources, Inc.* (*SERI*), 92 FERC ¶ 61,119, at 61,448-49 (2000)).

demonstrate the point. It also distinguished the Commission's *SERI* decision rejecting the net proceeds approach because (i) the proposal involved electric utility regulation, and (ii) unlike El Paso's support for its proposal, the Commission found that the utility failed to justify its position.[859]

574. The Presiding Judge, however, concluded that El Paso interpreted the Commission's *SERI* decision too narrowly. In addition, as with El Paso's attempt to change the Commission's DCF methodology, *infra*, the Presiding Judge found that the Commission's policy regarding the computation of the debt ratio is "clear and unambiguous," and rejected El Paso's position. The Presiding Judge also stated that a number of the other bases on which it rejected El Paso's methodological changes to the Commission-approved DCF methodology and *ROE Policy Statement* apply here as well.[860]

575. The Presiding Judge concluded that El Paso's position on this issue is based on a faulty premise, *i.e.*, that the gross proceeds methodology precludes full debt issuance cost recovery. As the Presiding Judge explained, the costs are amortized/recovered over the life of the loan because they are incorporated into the debt cost rate, which is 8.14 percent in this case.[861]

576. The Presiding Judge also rejected the significance of El Paso's illustrative, theoretical model. In this regard, the Presiding Judge stated that even if El Paso's model demonstrated that the proposed net proceeds methodology produces a full return, it does not necessarily prove that the Commission-approved gross proceeds methodology would not. More importantly, the Presiding Judge stated that El Paso once again ignores that it bears the threshold burden of proof by essentially arguing that the justness and reasonableness of the Commission-approved gross proceeds methodology must be measured against El Paso's alternative net proceeds approach. Given that the gross proceeds methodology is presumptively just and reasonable, the Presiding Judge stated that El Paso bears a threshold burden to prove the methodology is unjust and unreasonable in itself—not in comparison to an allegedly superior net proceeds alternative. Simply proving the net proceeds alternative just and reasonable does not satisfy this threshold requirement.

577. Finally, the Presiding Judge found that El Paso's theoretical model reflects so many implausible assumptions it would be difficult to accept as adequately supporting

[859] *Id.* P 64.

[860] *Id.* P 66 n.58.

[861] *Id*. P 68.

the net proceeds alternative. For example, the model assumes that the illustrative hypothetical company will (i) earn its exact allowed return every year, (ii) not retain any annual earnings, (iii) pay down its debt at a rate which keeps its debt to equity ratio constant, (iv) have a rate base that always equals total capitalization and (v) go out of business in ten years. The Presiding Judge concluded that the record suggests that the model fails to demonstrate what it purports to show even if all the assumptions are accepted because it temporally mismatches costs to revenues.[862]

Briefs on Exceptions

578. El Paso excepts to the Presiding Judge's rejection of the use of the net proceeds method for computing the debt ratio. El Paso argues again that only the net proceeds method will allow it to recover its cost of capital. El Paso states that the Initial Decision misconstrued the issue by confusing cost recovery with an opportunity to earn an authorized return. Specifically, El Paso argues that while the gross proceeds method may provide an opportunity to recover its debt issuance costs, it will not provide an opportunity to earn a return on the unamortized amount of debt issuance costs. El Paso analogizes this situation by stating that a pipeline need not be permitted to earn a return on the undepreciated cost of facilities because it will ultimately recover those costs through depreciation expense.[863]

579. In addition, El Paso contends that *SERI* is distinguishable because it is subject to specific electric regulations that do not exist for gas pipelines. In addition to being unable to fully recover its cost of capital, El Paso also argues that not being able to include debt issuance costs in rate base will create a disincentive for regulated companies to refinance debt at opportune moments to lower debt costs and shippers' rates.[864]

580. El Paso argues that as the proponent of a rate change under section 4 of the NGA, it has the burden to show that its proposed method is just and reasonable, but it is not required to show that other methods are unjust and unreasonable. Moreover, El Paso disputes the Presiding Judge's criticism of its witness's theoretical model by explaining that the alleged implausible assumptions are merely simplifying assumptions that do not invalidate the conclusions reached by the model.[865]

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[862] *Id.* P 69 (citing Ex. EPG-167 at 5; Ex. EPG-306; Ex. S-10 at 58; Ex. S-27 at 4-5; Tr. 1038-42; 1050-53; 1067-70).

[863] El Paso Brief on Exceptions at 46-47, 49-50.

[864] *Id.* at 47-48.

[865] *Id.* at 50-52.

Briefs Opposing Exceptions

581. Trial Staff opposes El Paso's exception and agrees with the Presiding Judge that Commission precedent requires that the debt ratio in El Paso's capital structure reflect the gross proceeds, or total principal outstanding, of its long-term debt issuances. In this regard, Trial Staff contends that the *Northwest* and *SERI* decisions are both applicable in this case.[866]

582. Trial Staff also argues that El Paso did not meet its burden of proving that the net proceeds method is just and reasonable. Trial Staff contends that El Paso did not provide any evidence to support its assertion that the gross proceeds method produces a disincentive that causes pipelines to forego the opportunity to refinance high cost debt. On the contrary, Trial Staff lists two incentives that pipelines have to refinance debt: (1) the savings of a refinancing can be retained under stated rates until a new rate case is filed, and (2) a lower interest rate on a pipeline's debt increases cash flow and enhances its credit rating.[867]

Commission Determination

583. The Commission affirms the Presiding Judge's finding that the gross proceeds method must be used to compute the debt ratio for El Paso's capital structure. The Commission agrees with the Presiding Judge that El Paso's attempts to distinguish the *Northwest* and *SERI* decisions are unavailing. The Commission recently rejected the use of the net proceeds method in the *Portland* decision.[868] In addition, the Commission agrees with the Presiding Judge that El Paso's argument that the gross proceeds method precludes the full recovery of the cost of capital is incorrect.[869]

584. El Paso's attempt to analogize how depreciation is treated in ratemaking with how the Commission has dealt with debt issuance costs is not persuasive. The two issues are different and warrant different treatment. Depreciation is taken on investments in rate base (primarily plant and equipment) that have been determined to be used and useful. The rate base on which depreciation is taken is amortized, or depreciated, over time while

[866] Trial Staff Brief Opposing Exceptions at 50.

[867] *Id.* at 62.

[868] *Portland Natural Gas Transmission System*, Opinion No. 524, 142 FERC ¶ 61,197, at P 263 (2013) ("We find that the holding in *SERI* [92 FERC ¶ 61,119] applies here and, thus Portland must use the gross proceeds method for its capital structure.").

[869] *Id.* P 264.

continuing to earn a return on the unamortized portion of the rate base. In contrast, there is no basis in ratemaking to allow a return to be earned on the unamortized portion of debt issuance costs. Rather, they are accounted for in determining the effective cost of debt, which is fully recovered in the return component of the revenue requirement.

585. In a case involving a similar issue of whether to allow a pipeline to earn a return on refinancing costs, the Commission stated that it has recognized the importance of refinancing debt to obtain lower interest rates and decrease rates for consumers by permitting pipelines to amortize premiums and other expenses for refinancing debt.[870] However, the Commission added that it has not permitted pipelines to earn carrying charges either as a return on equity or as interest on expenses incurred in refinancing debt. The Commission concluded by stating:

> The Commission's regulations and case law provide that the appropriate treatment of refinancing expenses is to amortize them. That is, a pipeline is entitled to a return of the refinancing costs, but not on the refinancing costs.[871]

B. El Paso's Loan to Parent and Undistributed Subsidiary Earnings (Stipulated Issue II.C)

586. The issue of whether and how much of El Paso's loan to its parent and/or its undistributed subsidiary earnings should be deducted from its equity capitalization was addressed in the 2008 Rate Case. In its order setting this case for hearing, the Commission specified, among other things, that the determination of the capital structure in this proceeding would be subject to the outcome of the 2008 Rate Case.[872]

Initial Decision

587. The Presiding Judge stated that El Paso and Trial Staff are the only participants addressing this issue and appear to agree that the appropriate amounts are: (1) $588,970,453 (Account No. 123, Investments in Associated Companies) and

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[870] *Kern River*, Opinion No. 486-A, 123 FERC ¶ 61,056 at P 251 (footnotes omitted).

[871] *Id.*

[872] *2011 Rate Case Suspension Order*, 133 FERC ¶ 61,104 at P 17.

(2) $150,753,070 (Account No. 216.1, Unappropriated, Undistributed Subsidiary Earnings).[873]

Commission Determination

588. In Opinion No. 517, the Commission directed El Paso to remove from its equity capitalization for ratemaking purposes the $615 million loan balance to El Paso Corporation and the $145 million of undistributed subsidiary earnings.[874] El Paso filed a request for rehearing of Opinion No. 517, and the Commission will address El Paso's arguments raised there in an order on rehearing. Therefore, as noted above, the determination of the capital structure in this proceeding will be subject to the Commission's findings in the rehearing order.

589. The record in this proceeding reflects the parties' agreement on the appropriate account balances implicated in the adjustment to El Paso's capital structure, based on the Commission's findings in Opinion No. 517. El Paso's updated end-of-test-period account balances will establish the basis for the capital structure adjustment in this proceeding, subject to rehearing of the Commission's ruling in the 2008 Rate Case. In the compliance phase of this proceeding, the Commission will address the rate impacts, if any, of the Commission's determination on rehearing of the Opinion No. 517.

590. In a compliance filing to reflect the rulings in Opinion No. 517, dated August 20, 2012, El Paso explained that, as with most of the cost of service elements, the amount of the loan to parent and the undistributed subsidiary earnings changed in its filing in this proceeding.[875] El Paso stated that it adjusted the equity component of the capital structure in its April Motion filing[876] by using the per book amounts of the loan to parent balance and undistributed subsidiary earnings reflected in the record of this proceeding as of March 31, 2011. Specifically, El Paso stated that the end-of-test-period actual

[873] ID, 139 FERC ¶ 63,020 at P 70.

[874] Opinion No. 517, 139 FERC ¶ 61,095 at PP 86-117.

[875] The Commission directed El Paso to file revised tariff records to adjust the rates in this proceeding to reflect all the rulings in Opinion No. 517, which included the removal of the excluded items from its capital structure. See the July 20, 2012 letter order in Docket No. RP12-816-000, 140 FERC ¶ 61,063.

[876] On April 1, 2011, El Paso submitted a "Motion to Place Rates into Effect," which reflected the elimination of facilities not placed in service by April 1, 2011. On May 5, 2011, the Commission issued a letter order approving the April Motion in Docket No. RP10-1398-002.

amounts are: a $588,970,453 balance of loan to El Paso's parent and $150,735,070 of undistributed subsidiary earnings.[877]

X. Return on Equity

A. Composition of Proxy Group

591. The determination of the allowed rate of return on common equity (ROE) for a gas pipeline company begins with the selection of an appropriate proxy group of companies. The use of a proxy group serves two purposes. First, the Commission-approved discounted cash flow (DCF) methodology requires market data – particularly data for common stock that is publicly traded. However, most gas pipeline companies are subsidiaries and lack such data. Therefore, to implement the DCF methodology, the data are obtained from a group of publicly-traded companies having a substantial proportion of their business in gas pipeline operations. These companies serve as a proxy for the gas pipeline company whose rates are at issue.[878] The Commission seeks to ensure that the proxy group selections are risk-appropriate.[879] As explained by the D.C. Circuit Court in *Petal Gas v. FERC*, the purpose of the proxy group is to:

> provide market-determined stock and dividend figures from public companies comparable to a target company for which these figures are unavailable. Market-determined stock figures reflect a company's risk level and, when combined with dividend values, permit calculation of the 'risk-adjusted expected rate of return sufficient to attract investors.'[880]

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[877] *See* Ex. EPG-247. In the compliance filing (at footnote 16), El Paso stated that P 70 of the Initial Decision in the 2008 Rate Case includes the amount for the undistributed subsidiary earnings with two transposed numbers.

[878] *Portland Natural Gas Transmission System*, Opinion No. 510, 134 FERC ¶ 61,129, at P 163 (2011).

[879] *Petal Gas Storage, LLC v. FERC*, 496 F.3d 695, 699 (D.C. Cir. 2007) (*Petal Gas v. FERC*); *see also Hope*, 320 U.S. 591, 603 ("the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks").

[880] *Petal Gas v. FERC*, 496 F.3d 695, 699 (quoting *Canadian Ass'n Petroleum Producers v. FERC*, 254 F.3d 289, 293 (D.C. Cir. 2001) (*CAPP v. FERC*)).

592. Moreover, certain of the inputs to a DCF analysis reflect estimates that necessarily introduce measurement error into the process. By taking an average of the DCF results of a proxy group of comparable risk companies, at least some of this unavoidable measurement risk can be eliminated, thereby providing a greater degree of confidence in the reasonableness of the average DCF result.[881] The Commission has found that the allowed ROE should be based on the median of the DCF results of the companies in the proxy group – unless highly unusual circumstances evidencing anomalously high or low risk can be shown to justify a deviation from the median ROE.[882] Since risk and return are highly correlated,[883] the expectation is that the use of the median DCF result will represent a reasonable estimate of the market cost of equity capital for the subject company.

593. In past years, Commission findings have tended to standardize the primary inputs to the DCF formula – the dividend yield and the growth factor. Therefore, the opportunity for litigation on such matters has been reduced significantly.[884] However, a new battleground has emerged in recent years – the selection of companies that should be included in the proxy group. To the extent there are disagreements over which companies and/or the number of companies that should be included in the proxy group, different resolutions of these disagreements would result in alterations in the range of reasonableness and the median of the range.

594. With this in mind, the Commission established various criteria to use when selecting companies to produce a proxy group that is comparable in risk to the subject company. Specifically, a company had to (1) have publicly-traded stock, (2) own one or more FERC-regulated interstate gas pipelines, (3) be considered by investors to be reflective of the risks of natural gas pipelines (as evidenced by its inclusion in an investor-oriented publication such as the Value Line Investment Survey), and (4) have at

[881] *Kern River*, Opinion No. 486-C, 129 FERC ¶ 61,240 at P 46 n.69.

[882] *Transcon. Gas Pipe Line Corp.*, Opinion No. 414-A, 84 FERC ¶ 61,084, *reh'g denied*, Opinion No. 414-B, 85 FERC ¶ 61,323 (1998) (*Transco*), *aff'd*, *CAPP v. FERC*, 254 F.3d 289.

[883] *See, e.g.*, *Consolidated Gas Supply Corp.*, 10 FERC ¶ 61,029, at 61,055-56 (1980) ("Equity carries a higher risk than long-term bonds and requires a higher return").

[884] Nonetheless, as discussed *infra*, El Paso argues in this proceeding that the Commission-approved DCF methodology should be changed in several respects.

least 50 percent of its assets devoted to, or operating income derived from, its natural gas pipeline business over the most recent three-year period.[885]

595. However, over time, mergers and acquisitions reduced the number of companies satisfying these criteria for selection. In response, the Commission sometimes modified the criteria to ensure that there were a sufficient number of companies in the proxy group.[886] Addressing this problem further, the Commission issued a Policy Statement endorsing the use of master limited partnerships (MLPs), along with corporations, in proxy groups.[887] While the Commission will accept a minimum of four companies in a proxy group, it has expressed a preference for at least five companies to enhance statistical accuracy.[888]

596. In Opinion No. 486-B, the Commission established an analytical framework for evaluating whether potential candidates for a proxy group have comparable risk. Among other things, the Commission returned to its historical preference for the 50 percent standard, *i.e.*, that proxy group companies have at least 50 percent of their assets devoted to, or 50 percent of their operating income derived from, the interstate gas pipeline business.[889]

597. In this proceeding, El Paso, Indicated Shippers, and Trial Staff agree on the inclusion of some companies in the proxy group, but disagree on others. The practical result of such disagreements is a difference in their recommended median ROE. In addition, El Paso argues that its allowed ROE should deviate from and be set "well above" the median ROE because of its asserted high risk relative to the proxy group companies. As discussed below, the Commission affirms the Presiding Judge's finding as to the composition of the proxy group, but reverses his finding that El Paso's allowed ROE should be set above the median ROE because of its allegedly high financial and business risk.

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[885] *Williston Basin Interstate Pipeline Co.*, 104 FERC ¶ 61,036, at P 35 n.46 (2003).

[886] *Id.* PP 34-43.

[887] *Composition of Proxy Groups for Determining Gas and Oil Pipeline Return on Equity*, 123 FERC ¶ 61,048 (2008) (*ROE Policy Statement*).

[888] *Kern River*, Opinion No. 486-B, 126 FERC ¶ 61,034 at P 104.

[889] *Id.* PP 91-92, 94, 97-99.

Initial Decision

598. Trial Staff, El Paso and Indicated Shippers all agreed that the proxy group should include Boardwalk Pipeline Partners, LP; TC Pipelines, LP; and Spectra Energy Partners, LP. There are disagreements over which other companies and how many other companies should be in the proxy group.

599. At the outset, the Presiding Judge emphasized that proxy group members must satisfy specific requirements to ensure their risks are comparable to the subject company whose ROE is being determined. In his view, the most important requirement is that any potential MLP proxy group member must have at least 50 percent of its assets devoted to, or 50 percent of its operating income derived from, interstate pipeline operations—i.e., satisfies the 50 percent standard.[890]

600. The Presiding Judge clarified that the Commission requires that the proxy group include a minimum number of four members, but prefers five members if representative entities can be found. The Presiding Judge added that the Commission only endorses larger groups (i.e., six or more members) if every constituent member strictly satisfies the 50 percent standard.[891]

601. The Presiding Judge agreed with El Paso, Trial Staff and Indicated Shippers and concluded that Boardwalk Pipeline Partners, LP; TC Pipelines, LP; and Spectra Energy Partners, LP should be included in the proxy group. He also concluded that Spectra Energy Corporation, which satisfies all Commission-specified criteria, including the 50 percent standard, should be included in the proxy group, as proposed by Trial Staff and Indicated Shippers. The Presiding Judge stated that it is appropriate to include both Spectra Energy Partners, LP and Spectra Energy Corporation in the same proxy group, consistent with Commission precedent in Opinion No. 510.[892]

602. According to the Presiding Judge, the selection of the fifth member of the proxy group should be made between Williams Partners, LP and El Paso Corporation because these two entities most nearly satisfy the criteria for proxy group selection. The Presiding Judge stated that of the two, the selection of Williams Partners, LP would require the Commission's 50 percent standard to be relaxed because Williams Partners,

[890] ID, 139 FERC ¶ 63,020 at P 36 (citing Opinion No. 510, 134 FERC ¶ 61,129 at P 163; *Petal Gas v. FERC*, 496 F.3d 695, 697).

[891] *Id.* P 36 n.25 (citing *Kern River*, Opinion No. 486-B, 126 FERC ¶ 61,034 at P 104).

[892] *Id.* P 37 (citing Opinion No. 510, 134 FERC ¶ 61,129 at PP 181-195).

LP currently devotes only 47.46 percent of its assets to interstate pipeline operations and derives only 44.70 percent of its operating income from interstate pipeline operations.[893]

603. The Presiding Judge found that the *ROE Policy Statement* expressly contemplates that there may be individual entities that do not satisfy all of the enumerated proxy group selection criteria, but still may be appropriate for inclusion on a case-specific basis.[894] The Presiding Judge found that the *ROE Policy Statement* permits the 50 percent standard to be relaxed so that Williams Partners, LP, which otherwise fully satisfies proxy group selection criteria, can be included in the proxy group. The Presiding Judge concluded that El Paso Corporation's non-investment grade credit rating is a more serious objection to its being included in the proxy group than Williams Partners LP's slightly lower than 50 percent of assets deployed to the interstate natural gas pipeline business.

604. In addition to El Paso Corporation, the Presiding Judge rejected three other proxy group candidates proposed by Indicated Shippers. Specifically, the Presiding Judge rejected the following: (1) TransCanada Corporation because it is subject to Canadian regulation and Canadian capital markets that have a different cost of capital; (2) Southern Union Company because it has an anomalously low 7.07 percent return on equity and also merged with another company in 2011; and (3) El Paso Pipeline Partners, LP because it exhibited a widely fluctuating indicated ROE and has a non-investment grade rating.

605. The Presiding Judge also rejected three proposed members of El Paso's eight member proxy group (Kinder Morgan Energy Partners, LP; ONEOK Partners, LP and Enterprise Products Partners, LP) because they all fail to satisfy the 50 percent standard.[895]

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[893] *Id.* P 38; *see, e.g.*, *SFPP, L.P.*, Opinion No. 511-A, 137 FERC ¶ 61,220, at P 302 (2011) (specifically excluding El Paso Corporation); Opinion No. 510, 134 FERC ¶ 61,129 at P 222 & n.301; *Kern River*, Opinion No. 486-B, 126 FERC ¶ 61,034 at PP 77, 80-81.

[894] *Id*. P 39 (citing *ROE Policy Statement*, 123 FERC ¶ 61,048 at P 79, *accord* Opinion No. 510, 134 FERC ¶ 61,129 at P 166; Opinion No. 486-B, 126 FERC ¶ 61,034 at P 91; Opinion No. 486-C, 129 FERC ¶ 61,240 at P 70).

[895] These companies were also excluded from the Opinion No. 510 proxy group because they did not exhibit comparable interstate natural gas pipeline profiles. *See* ID, 139 FERC ¶ 63,020 at P 37 n.28 (citing Opinion No. 510, 134 FERC ¶ 61,129 at PP 219-221)).

Briefs on Exceptions

606. El Paso argues that the Presiding Judge failed to analyze the relative risk profiles of the three rejected companies because of his interpretation of Commission policy on proxy group selection criteria. That policy, according to the Presiding Judge, requires the exclusion of any proxy group candidates that fail to satisfy the 50 percent standard once five companies have been chosen for the proxy group.[896]

607. El Paso argues that a larger sample size will produce more reliable ROE results and that this has led to a relaxation of the 50 percent standard in other cases. El Paso states that using a larger proxy group is particularly important in the current economic environment, especially when two of the five proxy companies selected in the Initial Decision have overlapping ownership.[897] While El Paso does not challenge the inclusion of both Spectra Energy Corporation and Spectra Energy Partners, LP in the proxy group, it argues that any cross ownership makes the five-member group less reliable.

608. Further, El Paso argues that the Initial Decision is inconsistent with Opinion No. 486-B. According to El Paso, the Commission found in that case that the oil and gas transmission industries were unusually homogeneous in operation, and exhibited similarities, if somewhat different risks. For this reason, El Paso argues that even though Kinder Morgan, ONEOK and Enterprise do not meet the traditional 50 percent standard, all have at least 50 percent of their assets or income devoted to interstate pipeline operations, including either gas, natural gas liquids or petroleum products, and at least 25 percent of their assets or income devoted exclusively to regulated natural gas pipelines.

609. Moreover, El Paso argues that the Commission accepted Kinder Morgan's inclusion in the proxy group in Opinion No. 486-B.[898] In this regard, El Paso relies on the explanation of its witness that the current markets and regulatory environments relating to natural gas liquids and product pipeline operations do not materially differ from those of interstate natural gas pipeline operations, and both have comparable risks and costs of capital.[899]

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[896] El Paso Brief on Exceptions at 20 (citing ID, 139 FERC ¶ 63,020 at P 36 n.25 and P 37 n.28).

[897] *Id.*

[898] *Id.* (citing *Kern River*, Opinion No. 486-B, 126 FERC ¶ 61,034 at PP 74-75).

[899] *Id.* at 19-21.

610. In addition, El Paso states that the Presiding Judge's reliance on Opinion No. 510 (citing Opinion No. 486-C, 129 FERC ¶ 61,240 at P 69) refers solely to sections discussing a firm's divergence from the "50 percent *transmission* rule" and the "*non-transmission* components" of a firm's business. Therefore, El Paso argues that the Commission found that companies engaged in the transmission of oil and products are sufficiently comparable to natural gas pipelines to include them in a proxy group, and do not present the difficult determinations regarding comparable risk that arise in connection with diversified gas companies that are significantly engaged in non-transmission activities.

611. Indicated Shippers argue that the Presiding Judge erred in including Williams Partners, LP in the proxy group, rather than El Paso Corporation. They contend that the record is not clear with regard to whether or not El Paso Corporation should be considered investment grade. According to Indicated Shippers, El Paso Corporation should be included in the proxy group because (1) El Paso Corporation is El Paso's owner, and it is most appropriate to use in a proxy group the publicly-traded parent company of the pipeline whose ROE is being established; (2) El Paso Corporation is the largest owner of U.S. interstate natural gas pipelines; and (3) El Paso Corporation has historically been included by the Commission in proxy groups used to calculate a range of reasonable returns for interstate natural gas pipelines.[900]

Briefs Opposing Exceptions

612. El Paso and Trial Staff argue that Indicated Shippers is incorrect in asserting that the Presiding Judge erred by including Williams Partners, L.P. rather than El Paso Corporation in the proxy group. Trial Staff's witness excluded El Paso Corporation because the company had a non-investment grade credit rating of BB, and because the company lowered the dividend it paid in January 2010. El Paso and Trial Staff take the position that the Presiding Judge correctly rejected El Paso Corporation based on the Commission's policy to exclude companies that do not have an investment grade rating from the proxy group. In their view, this is confirmed by the Commission's rejection of El Paso Corporation in Opinion No. 510 precisely because it did not have an investment grade rating.[901]

[900] Indicated Shippers Brief on Exceptions at 10.

[901] El Paso Brief Opposing Exceptions at 5 (citing Opinion No. 510, 134 FERC ¶ 61,129 at P 222 n.301; *SFPP, L.P.*, Opinion No. 511-A, 137 FERC ¶ 61,220 at P 302 (rejecting three companies that have credit ratings that are either below investment grade or none at all)).

613. El Paso also argues that Indicated Shippers failed to address the fact that El Paso Corporation was a target of an acquisition by Kinder Morgan, Inc. prior to the end of the six-month period in which Indicated Shippers' witness calculated a ROE for El Paso Corporation under the DCF method. This acquisition activity distorts the DCF analysis and is also a basis for excluding El Paso Corporation from the proxy group.[902] El Paso and Trial Staff argue that while Williams Partners, LP does not meet the Commission's 50 percent standard, relaxation of that standard is sometimes needed to achieve reliable results.[903]

614. Trial Staff opposes El Paso's exceptions on the composition of the proxy group and agrees that the Presiding Judge's proxy group of Spectra Energy Corporation; Boardwalk Pipeline Partners, LP; Spectra Energy Partners, LP; TC Pipelines, LP; and Williams Partners, LP is appropriate for use in determining El Paso's ROE in this proceeding.[904]

615. Trial Staff, as well as Indicated Shippers, oppose El Paso's request to include three additional companies (Kinder Morgan, ONEOK, and Enterprise) in the proxy group because none of those companies have significant interstate gas pipeline assets or operations and do not have risks sufficiently similar to El Paso's.[905]

616. Trial Staff and Indicated Shippers also state that El Paso's argument that the Commission should relax or modify its 50 percent threshold to include Kinder Morgan, ONEOK, and Enterprise is without merit. Trial Staff argues that the Commission only relaxes its 50 percent standard when it is necessary to achieve a proxy group of five companies. Therefore, since the Initial Decision approved a proxy group of five companies with significant natural gas assets, there is no need for further relaxation of the proxy group selection criteria.[906] In addition, Trial Staff and Indicated Shippers maintain

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[902] *Id.* at 6.

[903] *Id.* at 5 (citing *Kern River*, Opinion No. 486-B, 126 FERC ¶ 61,034 at P 103).

[904] Trial Staff's ROE calculations in Ex. S-10 at 28 and Ex. S-11, Schedule 10, reflect financial data through May 31, 2011. El Paso's test period ended on March 31, 2011, and its rates became effective on April 1, 2011.

[905] Trial Staff Brief Opposing Exceptions at 20; Indicated Shippers Brief Opposing Exceptions at 5-8.

[906] *Id.* at 20; Indicated Shippers Brief Opposing Exceptions at 5-7 (citing Opinion No. 510, 134 FERC ¶ 61,129, excluding Enterprise, Kinder Morgan, and ONEOK under the 50 percent threshold and noting that Enterprise and ONEOK have not been included in a gas pipeline proxy group).

that El Paso's three additional companies do not have risks comparable to natural gas pipelines, and were excluded in Opinion No. 510 on that basis.[907]

617. Trial Staff rejects El Paso's reliance on *Kern River* because (1) inclusion in that case was necessary to achieve a proxy group of five companies; (2) Kinder Morgan's combined oil and gas transmission business segment was not outweighed by oil transmission; and (3) the record indicated that investors viewed oil and gas pipelines as having similar, though not entirely comparable, risk profiles. Trial Staff states that the Commission more recently excluded Kinder Morgan from the proxy group in Opinion No. 510 because (1) it was not necessary to relax the 50 percent standard to reach a proxy group of five members; and (2) Kinder Morgan owned significant assets like gathering, processing, and treatment that are typically riskier than interstate transportation.[908]

618. Trial Staff rejects El Paso's argument that the product pipeline segments (natural gas liquids and oil) of its proposed proxy group companies "have comparable risks and costs of capital" to natural gas pipelines. In support of its position, Trial Staff argues that Kinder Morgan, ONEOK, and Enterprise (pipeline companies with higher amounts of liquids or product-related transmission business) have the three highest ROEs in El Paso's proxy group.[909]

619. Trial Staff argues that El Paso failed to carry its burden of showing that the companies it seeks to include in its proxy group share risks commensurate with interstate natural gas pipelines.[910] Trial Staff also contends that a larger sample size of proxy group companies is meaningless if the companies are not of comparable risk to the subject company. Trial Staff states that the Commission, in Opinion No. 510, rejected a party's proposal to diverge from Commission precedent because of turmoil in the financial markets and that the Commission maintained it was "crucial" that the risks of the proxy group companies be comparable to the subject company.[911]

620. Finally, Trial Staff opposes El Paso's contention that the Presiding Judge's inclusion of two companies with overlapping ownership in the proxy group, Spectra Energy Corporation and Spectra Energy Partners, makes the five-member group less

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[907] *Id.* at 22-23; Indicated Shippers Brief Opposing Exceptions at 7.

[908] Trial Staff Brief Opposing Exceptions at 23-24.

[909] *Id.* at 25-26 (citing Ex. S-11 at Schedule No. 13).

[910] *Id.* at 27.

[911] *Id.* at 28-29.

reliable and results in double counting. Trial Staff refers to facts evidencing that both companies are separate investments in the marketplace: (1) in Opinion No. 486-B, the Commission found that the two companies' assets were significantly distinct; (2) the two companies have different credit ratings and different market data, which demonstrate that investors view them as two separate and distinct investments; and (3) the companies have different projected growth rates and dividend rates.[912]

Commission Determination

621. The Commission affirms the Presiding Judge's selection of Boardwalk Pipeline Partners, LP; TC Pipelines, LP; and Spectra Energy Partners, LP as members of the proxy group. Significantly, all three of these MLPs satisfy the Commission's 50 percent standard for proxy members, *i.e.*, requiring that potential candidates for the proxy group have at least 50 percent of their assets devoted to, or 50 percent of their operating income derived from, interstate gas pipeline operations. The Commission further affirms the Presiding Judge's selection of Spectra Energy Corporation and Williams Partners, LP as the fourth and fifth members of the proxy group, as discussed below.

622. While both Trial Staff and Indicated Shippers include Spectra Energy Corporation in their respective, recommended proxy groups, El Paso suggests that selecting this company introduces some redundancy into the proxy group because of an overlap with Spectra Energy Partners, LP. The Commission, however, affirms the Presiding Judge's rejection of El Paso's position on this matter and will include Spectra Energy Corporation as the fourth company in the proxy group.[913] As in Opinion No. 510, the Commission here finds that it is not redundant to include both Spectra Energy Partners, LP and Spectra Energy Corporation in the same proxy group.[914]

623. For the fifth proxy group member, El Paso and Trial Staff agree on the selection of Williams Partners, L.P., although Indicated Shippers advocate the use of El Paso Corporation. The Presiding Judge selected Williams Partners, L.P over El Paso Corporation because the former had an investment-grade credit rating, while the latter did not, even though neither Williams Partners, L.P.'s assets nor its operating income satisfy the Commission's 50 percent standard, although they come close. The Presiding Judge stated that his selection was made on the assumption that the Commission has an

[912] *Id.* at 29-31.

[913] While El Paso raised the redundancy issue, it did not argue that Spectra Energy Corp. should be excluded from the proxy group. *See* Ex. EPG-310 at 12.

[914] Opinion No. 510, 134 FERC ¶ 61,129 at PP 192-195.

overarching requirement that all proxy group companies must have an investment-grade credit rating.

624. In addition to these six proxy group candidates, El Paso and Indicated Shippers propose the inclusion of several other companies – at least in part based on the proposition that additional companies in the proxy group are likely to produce a more accurate result from a statistical standpoint.[915] However, as Trial Staff explained, this argument has merit only if the additional companies are comparable in risk to the subject company.[916] In this regard, the Presiding Judge stated that the Commission endorses groups larger than five "only if every constituent member strictly satisfies the 50% Standard."[917]

625. Specifically, El Paso proposes to include Kinder Morgan, ONEOK, and Enterprise in the proxy group. The Commission affirms the Presiding Judge and rejects these three companies because none of them satisfies the Commission's 50 percent standard.

626. In addition to El Paso Corporation, Indicated Shippers propose to include Southern Union Company, El Paso Pipeline Partners, LP and TransCanada Corporation in the proxy group. The Commission affirms the Presiding Judge's ruling that, with the exception of El Paso Corporation, these companies should also be excluded from the proxy group. The Presiding Judge found that Southern Union Company's DCF result of 7.07 percent was "anomalously low,"[918] and Trial Staff determined it to be insufficient to attract investors when compared to interest rates on less-risky public utility debt.[919] El

[915] *See, e.g.*, El Paso Brief Opposing Exceptions at 5.

[916] Trial Staff Brief Opposing Exceptions at 28 (citing *Golden Spread Elec. Coop., Inc. v. Southwestern Public Service Co.*, 123 FERC ¶ 61,047, at P 62 n.126 (2008) ("While a larger group is generally desirable, the group cannot include companies that are not reflective of the subject companies . . . . [W]hen two groups' risk profiles are interchangeable, the larger group is statistically preferable."), and *Kern River*, Opinion No. 486-B, 126 FERC ¶ 61,034 at P 104 ("while the Commission agrees that adding more members to the proxy group results in greater statistical accuracy, this is true only if the additional members are appropriately included in the proxy group as representative firms")).

[917] ID, 139 FERC ¶ 63,020 at P 36 n.25 (citing Opinion No. 510, 134 FERC ¶ 61,129 at PP 169, 215 & n.294).

[918] *Id.* P 38 n.29.

[919] Ex. S-10 at 28-30 (showing a risk premium of only 109 basis points); *see also Kern River,* Opinion No. 486-A, 123 FERC ¶ 61,056 at P 158 & n.194).

Paso Pipeline Partners, L.P. also presents statistical problems because of its widely-fluctuating ROE and, in addition, it has a non-investment grade credit rating. Finally, TransCanada Corporation is subject to the vagaries of Canadian regulation and Canadian capital markets, thereby making it difficult to establish comparable risk.

627. Choosing the fifth member of the five-company proxy group between Williams Partners, LP and El Paso Corporation is a close call. On the one hand, Williams Partners, LP has an investment-grade credit rating, but also has assets and operating income that both fall just short of the Commission's 50 percent standard for the natural gas pipeline business. On the other hand, El Paso Corporation has a credit rating that is below investment-grade, according to at least one rating agency, but does have assets that meet the Commission's 50 percent standard for the natural gas pipeline business.

628. The DCF methodology requires that the companies in the proxy group have market data to estimate a pipeline subsidiary's allowed ROE. However, this approach works only if the companies in the proxy group are comparable in risk to the pipeline subsidiary whose rates are at issue. Establishing risk comparability is a difficult task because there are no risk measures that are infallible or risk factors that are always reliable. Indeed, the task is even more formidable because comparability in risk should be evaluated from the standpoint of investors' risk perceptions in the capital markets to the extent possible, rather than being based on the often self-serving judgment of litigants. This puts a premium on the use of published investor services that are widely relied on by investors to make their investment decisions.[920]

629. Since there are no published risk measures that can be reliably used to establish the equity risk of Pipeline A versus Pipeline B, the Commission first tries to establish comparable risk by identifying companies that are in the same line of business on the assumption that investors would view similar business operations as having similar risk. Nonetheless, even companies in the same industry can have different risks and be viewed differently by investors. The problem is that differences in risk perceptions by investors cannot be reliably determined because there are no risk measures or risk factors that can isolate the magnitude of these investor-perceived risk differences.

630. This is why the Commission, as an alternative, looks first to the percentage of assets or operating income in the natural gas business to identify plausible proxy group candidates. The Commission has established the 50 percent standard as a reasonable cutoff point for identifying comparable risk companies, *i.e.*, companies having at least 50

[920] In the past, for example, the Commission has relied on the investor rating services of Standard and Poor's (S&P), Moody's, and Fitch, as well as the Value Line Investment Survey, in making its selections of comparable risk companies.

percent of assets devoted to, or 50 percent of operating income derived from, the natural gas pipeline business.[921]

631. In an attempt to further refine the selection process, the Commission also takes into account the credit ratings of companies on the assumption that such ratings, although not focused exclusively on equity risk, are nevertheless used by equity investors in developing their risk perceptions. Common sense dictates that a company with a high credit rating will be perceived as a lower risk by equity investors than a company with a low credit rating.[922]

632. The Presiding Judge's finding was based on an interpretation that the Commission always required that a proxy group company have an investment-grade credit rating. While El Paso and Trial Staff adhere to this interpretation, Indicated Shippers do not. The Commission agrees with Indicated Shippers that, while the Commission has a preference for the use of proxy companies with an investment-grade rating (because they tend to lend more stability to the data used in the DCF model), it does not have an absolutist position on this matter.

633. In the latest *Portland* decision, which postdated the Initial Decision and exceptions briefs in this proceeding, the Commission explained that the circumstances in a particular case might cause the Commission to allow a company with a non-investment grade rating to be included in the proxy group.[923] Indeed, two of the MLPs selected for the proxy group in this proceeding (TC Pipelines, LP and Spectra Energy Partners, LP) do not have any credit ratings at all by the three major rating agencies.[924] Therefore, their selection here, as well as in other proceedings, has obviously been based on other considerations.

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[921] Opinion No. 510, 134 FERC ¶ 61,129 at P 167 (citing *Kern River*, Opinion No. 486-B, 126 FERC ¶ 61,034 at P 91; Opinion No. 486-C, 129 FERC ¶ 61,240 at PP 60, 70).

[922] *See, e.g.*, *Kern River*, Opinion No. 486-B, 126 FERC ¶ 61,034 at P 137 ("It is correct that a strong credit rating implies a greater ability to provide consistent returns to the firm's shareholders and to raise capital for future growth.").

[923] Opinion No. 524, 142 FERC ¶ 61,197 at PP 304-307 ("As we found in Opinion No. 510, the advantage of including in the proxy group a firm whose business activities are so similar to Portland's outweighs other factors, such as a non-investment rating from one of the three rating agencies." Footnote omitted.).

[924] If a company had no bond rating, as in these examples, but was a subsidiary of a rated parent, El Paso's witness assigned the parent's credit rating to the subsidiary. Ex. EPG-179 at 29 n.40.

634. If a decision had to be made between Williams Partners, LP and El Paso Corporation solely based on their credit ratings and pipeline percentages, the Commission would choose El Paso Corporation for the proxy group because of its compliance with the 50 percent standard. However, there are other risk factors in the record that should be considered as well. Specifically, Trial Staff states that El Paso Corporation reduced its dividend in 2010,[925] which can distort a DCF analysis. Moreover, El Paso argues that El Paso Corporation was the target of an acquisition by Kinder Morgan, Inc.,[926] which can also affect the reliability of a DCF result. Therefore, when these two factors are combined with the non-investment grade rating of El Paso Corporation, concerns are raised about the stability of the data inputs to the DCF formula.

635. Although Williams Partners, LP does not satisfy the 50 percent standard, its percentages of assets and operating income in the natural gas pipeline business come very close to meeting this standard.[927] Moreover, as Trial Staff points out, its less-risky or more-risky non-gas pipeline business segments do not substantially outweigh its gas pipeline operations.[928] The Commission will evaluate the totality of the circumstances to determine whether a particular company should be included in the proxy group. Based on such an evaluation, the Commission finds that Williams Partners, LP should be included as the fifth and final member of the proxy group.

636. Accordingly, the Commission approves a proxy group in this case consisting of four MLPs (Boardwalk Pipeline Partners, LP; TC Pipelines, LP; Spectra Energy Partners, LP; and Williams Partners, LP) and one corporation (Spectra Energy Corporation).

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[925] Trial Staff Brief Opposing Exceptions at 33 (citing Ex. S-10 at 20-21; Ex. S-25 at 2-3).

[926] While El Paso explained that the merger announcement was made on October 16, 2011 (El Paso Brief Opposing Exceptions at 6 n.8), it is reasonable to conclude that negotiations were taking place for a significant period of time prior to that date.

[927] On the other hand, Trial Staff contends that El Paso's own analysis shows that 51.21 percent of the income earned by Williams Partners, LP was derived from natural gas pipeline operations. Trial Staff Brief Opposing Exceptions at 20 (citing Ex. EPG-179 at 31, Table 1; Ex. EPG-181 at B-5).

[928] Trial Staff Brief Opposing Exceptions at 19-20 (citing Opinion No. 510, 134 FERC ¶ 61,129 at P 167).

B. DCF Analysis

637. The DCF model historically used by the Commission is based on the premise that a stock's price is equal to the present value of the infinite stream of expected dividends discounted at a market rate commensurate with the stock's risk.[929] With simplifying assumptions, the formula for the DCF model reduces to:

> P = D/ (r-g), where "P" is the price of the stock, "D" is the current dividend, "r" is the discount rate, and "g" is the expected growth rate in dividends.

638. For ratemaking purposes, the Commission rearranges the formula to solve for the discount rate, which represents the rate of return that investors require to invest in a firm – otherwise known as the market cost of equity capital:

> r = D/P + g, where "r" is the ROE, "D/P" is the current dividend yield (dividends divided by price), and "g" is the expected growth rate in dividends.[930]

639. To reflect the quarterly payment of dividends, the dividend yield is multiplied by (1 + g).[931] Therefore, the Commission's DCF formula becomes: r = D/P (1+g) + g.

640. For purposes of calculating the current dividend yield, the Commission traditionally uses a six-month average of dividends and prices.[932] For purposes of estimating the expected growth rate in dividends, the Commission employs a two-step procedure, whereby short-term and long-term estimates are averaged. For the short-term estimate of growth, the Commission uses published five-year forecasts of earnings by investment analysts. For the long-term estimate of growth for corporations, the Commission uses forecasts of gross domestic product (GDP), as reflective of the

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[929] *CAPP v. FERC*, 254 F.3d 289, 293.

[930] *National Fuel*, 51 FERC at 61,337 n.68; *Ozark Gas Transmission Sys.*, 68 FERC ¶ 61,032, at 61,104 n.16 (1994).

[931] *See, e.g.*, *Trunkline,* Opinion No. 441, 90 FERC at 61,112.

[932] *Boston Edison Co.*, 42 FERC ¶ 61,374, at 62,093 (1988), *reh'g denied*, 43 FERC ¶ 61,309 (1988), *aff'd*, *Boston Edison Co. v. FERC*, 885 F.2d 962 (1st Cir. 1989).

expected, long-term growth of the economy as a whole.[933] In the *ROE Policy Statement*[934] and Opinion No. 486-B,[935] the Commission found that the long-term growth rate of MLPs will be less than that of corporations, because MLPs retain less of their earnings. Based on the record in the Opinion No. 486-B proceeding, the Commission concluded that the long-term growth projection for the proxy group MLPs should be 50 percent of long-term growth in GDP.

641. In combining the two estimates, the Commission applies a two-thirds weighting to the short-term estimate and a one-third weighting to the long-term estimate.[936] When applied to each of the companies in the proxy group, the Commission's DCF methodology produces a range of reasonableness for the ROE, within which the subject company's allowed ROE is set based on an evaluation of its risk compared to the average risk of the proxy group companies.

642. As a general matter, there is no dispute among the parties and Trial Staff about the DCF methodology itself. In this proceeding, however, El Paso proposes to make several changes to the Commission-approved DCF methodology. For the reasons discussed below, the Commission rejects El Paso's recommendations and affirms the Presiding Judge's rulings. Based on the Commission's traditional DCF analysis and the five-member proxy group adopted in this proceeding (Boardwalk Pipeline Partners, LP; TC PipeLines, LP; Spectra Energy Partners, LP; Spectra Energy Corporation; and Williams Partners, LP.), the range of reasonableness for the ROE is 10.39 percent to 11.08 percent, with a median of 10.55 percent.[937]

1. <u>Benchmark Model</u>

643. El Paso argues that the Benchmark Model used by its witness for estimating the cost of capital of the MLPs in the proxy group should be adopted. That method seeks to estimate the cost of capital of the MLP as a whole, including both the general partner

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[933] *Northwest Pipeline Corp.*, Opinion No. 396-B, 79 FERC ¶ 61,309, at 62,383 (1997); *Williston I*, 79 FERC at 62,389; *aff'd in relevant part*, *Williston v. FERC*, 165 F.3d 54 at 57 (1999).

[934] *ROE Policy Statement*, 123 FERC ¶ 61,048 at PP 88-106.

[935] *Kern River*, Opinion No. 486-B, 126 FERC ¶ 61,034 at PP 124-130.

[936] *Transco*, Opinion No. 414-A, 84 FERC at 61,423-24; Opinion No. 414-B, 85 FERC at 62,266-70; *aff'd CAPP v. FERC*, 254 F.3d 289.

[937] *See* Ex. S-11, Schedule No. 11.

interest and the limited partner interest.[938] By contrast, the *ROE Policy Statement*[939] found that the DCF analysis should be conducted solely with respect to the limited partner interest, and the Commission has followed that approach in subsequent individual cases.

644. The general partner interest is not publicly traded in the capital markets, while the limited partner interest is. At their inception, MLPs establish agreements between the general and limited partners, which define how the partnership's cash flow is to be divided between the general partner and limited partner interests. Such agreements generally provide for the general partners to receive increasingly higher percentages of the overall distribution, if the partners are able to increase that distribution above defined levels. The Benchmark Model assumes that, as a result of these incentive distribution rights, a DCF analysis of the MLP as a whole should (1) include higher projected growth rates for the general partner interest than for the limited partner interest and (2) a correspondingly higher value for the general partner interest than the publicly-traded limited partner units which would, in turn, reduce the general partner interest's current "dividend" yield. The *ROE Policy Statement* found that use of the Benchmark Model would be inconsistent with the purpose of the proxy group of providing a fully market-based estimated cost of capital, because the general partner interest is not publicly traded.

645. The Presiding Judge found that El Paso's Benchmark Model is not an application of the DCF methodology, but rather an approach that fundamentally deviates from the Commission's DCF model in a number of ways.[940] Based largely on the Commission's rejection of the Benchmark Model in the proceeding resulting in the *ROE Policy Statement*, the Presiding Judge rejected the use of the Benchmark Model in this proceeding.[941] The Commission affirms rejection of the Benchmark Model in this proceeding.

646. The proceeding resulting in the *ROE Policy Statement* raised several issues that cast doubt on the reliability of the Benchmark Model. Among them are the model's internal operations and their relative lack of transparency, as well as the model's reliance on calculated market data, which is inconsistent with the DCF's fully market-based

[938] El Paso Brief on Exceptions at 34 (citing Ex. EPG-179 at 36 (Vilbert test.)).

[939] *ROE Policy Statement*, 123 FERC ¶ 61,048 at PP 101-104.

[940] ID, 139 FERC ¶ 63,020 at P 43.

[941] *Id.* P 43 n.36 (citing *ROE Policy Statement*, 123 FERC ¶ 61,048 at PP 1-2, 29-41, 101-106) and P 44.

estimate of the cost of equity capital.[942] More importantly, as discussed below, El Paso has not dispelled the Commission's concerns regarding these issues in this proceeding. Under these circumstances, the Commission is unable, based on the testimony in this case, to find that the use of the Benchmark Model is just and reasonable.

647. El Paso's witness incorporates both the general partner and limited partner interests into his DCF estimates of the market cost of equity for the MLPs in the proxy group. However, only the limited partner interests are traded in the capital markets, and investment analysts only make five-year projections for the limited partner interests. Therefore, to reflect an MLP's general partner interests in his modified DCF analysis, El Paso's witness had to engage in a separate analysis to develop "implied" market prices, dividends, and earnings projections.

648. In *Petal Gas v. FERC*, as discussed *supra*, the D.C. Circuit Court stated that the purpose of a proxy group is to "provide market-determined stock and dividend figures from public companies comparable to a target company for which these figures are unavailable."[943] General partner interests, as noted above, are not publicly traded and cannot directly provide market-determined stock and dividend figures. Therefore, the market figures imputed by El Paso's witness to the general partner interests are at best speculative.

649. Moreover, the Benchmark Model relies on various assumptions that may or may not be reasonable. One of these assumptions seems to be that the Benchmark Model's methodology produces the most appropriate estimate of the market cost of equity for use in the DCF analysis of the MLPs in the proxy group, because it reflects both general partner and limited partner equity interests.[944] However, the Commission is unable to conclude that this assumption has been established as true. The Commission has consistently limited its DCF analysis of the corporations in the proxy group to their publicly-traded common stock. For example, to the extent a corporation has or had preferred stock in its capital structure, the Commission's traditional DCF methodology does not attempt to incorporate this preferred equity interest into some combined estimate of the cost of equity. Rather, the Commission has focused on the cost of the

[942] *See ROE Policy Statement*, 123 FERC ¶ 61,048 at P 104.

[943] *Petal Gas v. FERC*, 496 F.3d 695, 699; *see also Southern California Edison Co. v. FERC*, 717 F.3d 177, 179 (D.C. Cir. 2013).

[944] Ex. EPG-179 at 36 n.48 ("The primary reason for my preference for the benchmark model is that it explicitly considers all the equity in the MLP, not just the [limited partner] equity.").

corporation's publicly-traded common stock, and we see no reason to depart from that practice with respect to MLPs.

650. While the preference of El Paso's witness for the Benchmark Model is based on his belief that it is a more accurate model,[945] the validity of his belief is not demonstrated by the record evidence. Given that MLPs finance their growth through the sale of publicly-traded limited partner interests, as do corporations when issuing their common stock, we do not see the relevance of knowing the cost of equity to private general partner interests – even if it could be reasonably estimated.

651. Finally, from a fundamental standpoint, the cost of equity capital is an opportunity cost in the sense that it reflects the opportunity to invest in alternative investments of comparable risk.[946] The companies in the proxy group are intended to represent alternative investments of comparable risk in which investors have an opportunity to invest. However, there is no opportunity for investors to invest in an MLP as a general partner (or fractional general partner). As El Paso's witness acknowledges, investments in the general partner and limited partner components of an MLP constitute different investments with different risks.[947] Accordingly, the Commission finds that the market cost of equity should continue to be estimated based solely on a DCF analysis of the publicly-traded limited partner investment.

2. <u>Long-Term Growth Rate for MLPs</u>

652. Related to the implementation of the Benchmark Model is El Paso's argument that the long-term growth rate for MLPs should be based on the GDP in its entirety, rather than 50 percent of the GDP. As with the Benchmark Model, the Presiding Judge rejected El Paso's position that the full GDP growth rate should be used based on the fact that it had been fully addressed and rejected in the *ROE Policy Statement*.[948] On exceptions, El Paso contends again that the Presiding Judge's finding is incorrect because it erroneously relied on a Policy Statement with no other record evidence for support.[949]

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[945] Ex. EPG-179 at 36.

[946] *Id.* at 5.

[947] *Id.* at 36.

[948] ID, 139 FERC ¶ 63,020 at P 43 (citing *ROE Policy Statement*, 123 FERC ¶ 61,048 at P 42).

[949] El Paso Brief on Exceptions at 31-32.

653. Based on the Commission's finding above to reject the use of the Benchmark Model, and its related general partner interest, the case for using a full GDP forecast in a DCF analysis to estimate the long-term growth in earnings is weak. According to El Paso's witness, the long-term growth rate for an MLP as a whole "is not likely to differ from that of an otherwise identical corporation."[950] The issue then becomes what the impact on the long-term growth rate will be if only the limited partner interest of an MLP is considered. El Paso's witness explains that limited partner interests will have a lower long-term growth than an MLP entity as a whole "because of the way in which MLPs finance their operations."[951] Therefore, without the general partner long-term growth reflected in the DCF analysis, it follows that MLPs are likely to experience long-term growth that is lower than the full GDP forecast, which is applied to corporations.

654. This same long-term growth issue was fully litigated in *Kern River*[952] subsequent to the *ROE Policy Statement*. Based on the record evidence in that proceeding, which included forecasts of MLP growth by several investment firms, the Commission concluded that there was adequate support for the proposition that MLPs, on average, are expected to grow at a slower rate than corporations over the long term. Indeed, the Commission stated that "[t]he record here only reinforces the conclusions of the Policy Statement."[953]

655. As described by the Commission in *Kern River*, both Trial Staff and BP referenced long-term growth estimates published by Citigroup, Merrill Lynch, and Wachovia for MLPs that were generally lower than the 50 percent of the GDP forecast used by the Commission for the year 2004.[954] However, the Commission concluded that the growth rates accorded MLPs by Merrill Lynch and Citigroup were unduly low and determined that the Wachovia forecasts cited by BP, which actually approximated 50 percent of long-term GDP for 2004 and 2007, were more reasonable.[955] El Paso has presented no evidence to suggest that investment houses no longer estimate lower long-term growth rates for MLPs than for corporations.

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[950] Ex. EPG-179 at 39.

[951] *Id.*

[952] *Kern River*, Opinion No. 486-B, 126 FERC ¶ 61,034 at PP 125-128.

[953] *Id.* P 126.

[954] *Id.*

[955] *Id.* P 128.

656. Based on the record evidence, the Commission in *Kern River* upheld its decision in the *ROE Policy Statement* to retain 50 percent of the GDP forecast as the long-term growth estimate in the DCF formula. As the Commission stated, "[t]his will assure that MLPs receive comparable returns for firms of similar risks with an adjustment to reflect the intrinsic difference in the long-term growth prospects of Subchapter C corporations and the gas pipeline MLPs at issue here."[956] Accordingly, the Commission concludes that it is reasonable to continue to adhere to the use of 50 percent of a GDP forecast as the long-term growth estimate in a DCF analysis because this issue "was clearly raised, considered, and resolved by the Commission."[957]

3. Historical Average GDP versus Current GDP

657. El Paso argues that the measure of long-term growth for the proxy group companies should be based on an historical average GDP, rather than current forecasts of GDP. Deeming the current GDP forecasts as too pessimistic because of the recessionary economic conditions, El Paso substituted a long-term (1929-2009) annualized growth rate, to which it applied the EIA inflation rate forecast for a 20-year period beginning in 2016.[958] The Presiding Judge rejected El Paso's approach as an unwarranted methodological deviation from the Commission's DCF methodology.[959] The Commission affirms the Initial Decision. There is no question that a DCF estimate is intended to reflect investors' current expectations. Although forecasts of any kind are inherently imprecise, it seems reasonable to believe that current expectations are more likely to reflect current GDP forecasts than historical forecasts, particularly those that extend back into the distant past.

4. Calculation of Dividend Yield

658. El Paso argues that the dividend yield calculation should be based on the most recent month of dividends annualized, rather than the most recent six-month average of dividend yields. The Presiding Judge rejects El Paso's position because, among other

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[956] *Id.*

[957] *Williston v. FERC,* 165 F.3d 54, 61 (citing *Michigan Wisconsin Pipe Line Co. v. FPC*, 520 F.2d 84, 89 (D.C. Cir. 1975) ("There is no question that the Commission may attach precedential, and even controlling weight to principles developed in one proceeding and then apply them under appropriate circumstances in a stare decisis manner.").

[958] ID, 139 FERC ¶ 63,020 at P 45 (citing Ex. EPG-179 at 35-36).

[959] *Id.* P 46.

things, the Commission had "expressly rejected" it in Opinion No. 510, "because it mismatches stock prices and the dividends used to calculate dividend yield, and likely overstates dividend yield."[960] Moreover, the use of a six-month average dividend yield is a longstanding Commission policy that represents a reasonable measurement period to properly implement the DCF methodology.[961] The Commission affirms the Initial Decision.

C. Placement of El Paso's ROE within Proxy Group

Initial Decision

659. The Presiding Judge found that El Paso succeeded in showing that its risk factors demonstrate highly unusual circumstances that indicate an anomalously high risk, which justified placing it above the median ROE of the recommended proxy group.[962] According to the Presiding Judge, each of the risk factors evaluated is uncommon but, taken together, they are rare, thereby satisfying the "highly unusual circumstances" and anomalously high risk" requirements.[963] However, the Presiding Judge left it to the Commission to decide where above the median ROE to place El Paso's ROE. In making his determination as to El Paso's relative risk, the Presiding Judge evaluated El Paso's financial risk and business risk.

660. With respect to financial risk, the Presiding Judge found that S&P rates El Paso's financial risk profile as "aggressive," which ranks it at 5 out of 6 on a scale where 1 represents "minimal" financial risk and 6 represents "highly leveraged." Since the

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[960] *Id.* P 45 (citing Opinion No. 510, 134 FERC ¶ 61,129 at P 234; *see also New England Power Co.*, Opinion No. 158, 22 FERC ¶ 61,123, at 61,187-88 (1983) ("If current dividend yield (D/P) is to be accurately calculated, the dividend used in the numerator must be consistent with the market price used in the denominator. The price that investors will pay for common stock at a given time reflects, among other things, investors' decisions based on the dividend they would receive as shareholders at that time. Consequently, mismatching the dividend from one period with the stock price from a different period can result in a distorted dividend yield.").

[961] *See, e.g., Blue Ridge Power Agency*, 55 FERC ¶ 61,509, at 62,783 (1991) ("We have generally adopted a six-month period in individual rate cases as a fair balance between overly long and excessively short measurement periods." Footnote omitted.).

[962] ID, 139 FERC ¶ 63,020 at P 62.

[963] *Id.*

average risk of the proxy group on this scale is 4 ("significant"), the Presiding Judge found that El Paso has higher than average financial risk compared to the proxy group.[964]

661. While S&P rated El Paso's business risk profile as "excellent," the Presiding Judge nonetheless found that the record evidence supports the conclusion that El Paso has anomalously high business risk because (1) its average remaining firm transmission contract life is shorter than the contract lives of the industry and the proxy group; (2) its declining throughput elevates both its business and regulatory risks; (3) its competitive risk is exacerbated by its regulatory risk; (4) it displays enhanced competitive/business risks in its primary (California and Arizona) markets; and (5) almost 50 percent of its long-term firm capacity is subscribed under sculpted contracts.[965]

Briefs on Exceptions

662. Trial Staff argues that the Presiding Judge erred in finding that El Paso satisfied the "highly unusual circumstances" and "anomalously high risk" requirements for approval of a ROE above the median ROE of the proxy group. Indeed, Trial Staff states that once an appropriate proxy group has been determined, the Commission has never found that any pipeline company (or intervenor) has persuasively shown the highly unusual circumstances required to justify a ROE above (or below) the median.[966]

663. In particular, Trial Staff criticizes the Presiding Judge's rejection of the S&P report that gave El Paso an excellent business risk rating,[967] even though the Presiding Judge acknowledged that this rating is specifically for El Paso and not its parent, El Paso Corporation.[968] Trial Staff contends that this rejection is inconsistent with the Presiding Judge's adoption of both S&P's financial risk assessment and its business risk assessment of the length of El Paso's remaining firm contracts. The Presiding Judge's rejection of

[964] *Id.* P 48.

[965] *Id.* PP 50-57. The Presiding Judge defined sculpted contracts as contracts that "establish firm shipper capacity entitlements which vary by month or season to match actual demand." *Id.* P 57 n.55.

[966] Trial Staff Brief on Exceptions at 22.

[967] *Id.* at 22 (citing ID, 139 FERC ¶ 63,020 at PP 58-59).

[968] *Id.* at 26 (citing ID, 139 FERC ¶ 63,020 at P 50 n.42, PP 58-59).

S&P's business risk rating for El Paso is also contrary to the Commission's acceptance and use of credit ratings and business risk profile ratings.[969]

664. Specifically, Trial Staff asserts that the Commission has repeatedly affirmed that "[issuer credit ratings], as well as business risk profile ratings, are useful criteria in evaluating relative risk [because] rating agencies . . . use many factors that would be relevant to an equity investor's analysis of a firm's business prospects."[970] Trial Staff argues that the risk profiles published by investment advisory services are widely available, objective, and the best available indicator of a company's risk because investors rely on these publications when contemplating their own investment decisions and thus reflect their own views of a company's relative risk.[971] According to Trial Staff, the use of these investor service ratings has the added benefit of preventing parties from challenging objective measures of risk based on speculative, self-serving, and cherry-picked risk factors.[972]

665. Based on these investor service reports, Trial Staff's witness concluded that El Paso's financial risk, on a stand-alone basis, "is slightly higher than the proxy group, its business risk is slightly lower than the average of the proxy group," and its overall risk, taking into account both financial risk and business risk, "is comparable to that of the proxy group."[973] Indeed, S&P's rating of "excellent" for El Paso's stand-alone business risk profile, *i.e.*, not El Paso Corporation, indicates a lower risk level than any of the rated companies in the recommended proxy group.[974]

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[969] *Id.* at 22 (citing ID, 139 FERC ¶ 63,020 at PP 48, 50).

[970] *Id.* at 22-23 (citing *Kern River*, Opinion No. 486-B, 126 FERC ¶ 61,034 at P 137; *Kern River*, Opinion No. 486, 117 FERC ¶ 61,077 at P 177 (citing *Transco*, Opinion No. 414-A, 84 FERC at 61,427; *Transcon. Gas Pipeline Corp.*, 90 FERC ¶ 61,279, at 61,937 (2000); *Williston III*, 84 FERC at 61,388; Opinion No. 510, 134 FERC ¶ 61,129 at P 267).

[971] *Id.* at 23-24 & n.40.

[972] *Id.* at 25.

[973] *Id.* (citing Ex. S-10 at 38; Ex. S-25 at 2-3).

[974] *Id.* at 25 & n.46; *see also* Ex. S-12 at 92-94 (El Paso's "excellent" business risk rating, 1 out of 6 on the S&P scale, compares to the "strong" business risk profiles, 2 out of 6, for Spectra Energy Corporation and Boardwalk Pipeline Partners, LP, and the "satisfactory" business risk profile, 3 out of 6, for William Partners, LP. S&P does not provide a rating for TC Pipelines, LP and Spectra Energy Partners, LP.).

666. With respect to credit ratings, Fitch's rating for El Paso is BBB- (positive), while Moody's similarly rates El Paso as Baa3 (positive).[975] According to Trial Staff, the Presiding Judge correctly noted that S&P's BB rating for El Paso is actually a consolidated credit rating for its parent, El Paso Corporation, and not a stand-alone rating for El Paso.[976] That being the case, Trial Staff argues that the financial and business risks of the parent are not representative of El Paso's business and financial risks.[977]

667. Trial Staff contends that based on S&P's Business and Financial Risk Profile matrix, and using S&P's stand-alone ratings for El Paso of "aggressive" for financial risk and "excellent" for business risk, a credit rating of BBB would result for El Paso. El Paso's implied credit rating of BBB (or even its actual ratings of BBB- and Baa3) places it within the range of BBB+ to BBB- for the proxy group companies.[978] As noted previously, in Opinion No. 510 the Commission affirmed the Presiding Judge's finding there that the pipeline company had approximately the same business risk as the proxy group companies because its credit rating was within the range of credit ratings for the proxy group.[979]

668. Trial Staff also argues that El Paso's witness' analysis is deficient because it reflects only the witness's assessment of each pipeline's business risk and not that of investors or the Commission.[980] In Trial Staff's view, the failure of El Paso's witness to consider the assessments of El Paso and the proxy group companies by investor services would inappropriately substitute El Paso's own risk perceptions for those of investors.[981]

669. In taking exception to the Presiding Judge's relative risk findings, Trial Staff and Indicated Shippers both argue that a meaningful risk assessment must compare El Paso's risk against the risk of the companies in the proxy group. They contend that no witness in this proceeding examined the risk factors discussed in the Initial Decision and

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[975] *Id.* at 26 (citing Ex. S-10 at 37; Ex. S-25 at 2-3; Ex. S-12 at 70, 75-80).

[976] *Id.* at 27 (citing ID, 139 FERC ¶ 63,020 at P 48 n.40).

[977] *Id.* at 27-28 (citing Ex. S-10 at 37; Ex. S-25 at 2-3; Ex. S-12 at 160).

[978] *Id.* at 27 & n.54.

[979] *Id.* at 26-27 (citing Opinion No. 510, 134 FERC ¶ 61,129 at P 250 n.345, P 267).

[980] *Id.* at 52 & n.141.

[981] *Id.* at 52.

compared them to those of the companies in the proxy group. They conclude that it is speculation whether El Paso is affected more severely than other proxy group companies by any of the risk factors discussed by the Presiding Judge.[982]

670. Trial Staff contends that none of El Paso's witnesses conducted a proper analysis comparing the risks of El Paso with those of the companies in the proxy group. For example, when comparing the risks of El Paso with those of the proxy group companies, the results of the DCF model compensate investors for the risks associated with all the business segments of the proxy group companies – not just their Commission-regulated gas pipeline business segments.[983] Trial Staff argues that the problem is compounded by the fact that El Paso's witness did not even provide a comprehensive comparison of El Paso's business risk with that of the gas pipeline subsidiaries of the proxy group companies.[984]

671. Indicated Shippers also argue that the Presiding Judge erred in finding that El Paso has anomalously high business risk compared to the proxy group. Indicated Shippers agree with Trial Staff that the Presiding Judge's finding is inconsistent with the findings of the same S&P ratings system that the Presiding Judge relied on to determine financial risk.[985] Indicated Shippers argue that the Presiding Judge's reliance on El Paso's remaining FT contract life to find higher than average business risk is also inconsistent with the Presiding Judge's acknowledgement that the record evidence does not contain any analysis of El Paso's remaining FT contract life compared to the proxy group companies.[986]

672. In addition, Indicated Shippers argue that the Presiding Judge erred when he stated that the evidence confirms that El Paso's declining throughput elevates both its business and regulatory risks.[987] According to Indicated Shippers, this determination is inconsistent with the later finding of the Presiding Judge that "a maximum of only two to

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[982] *Id.* at 35 (citing Opinion No. 510, 134 FERC ¶ 61,129 at PP 266-268).

[983] *Id.* at 53 (citing *Kern River*, Opinion No. 486-B, 126 FERC ¶ 61,034 at P 86).

[984] *Id.* at 54-55 & n.149 (citing Ex. S-30), n.150, n.151.

[985] Indicated Shippers Brief on Exceptions at 12; *cf*. ID, 139 FERC ¶ 63,020 at P 48 with ID P 50 n.42).

[986] *Id.* at 13 (citing ID, 139 FERC ¶ 63,020 at P 50 n.42).

[987] *Id.* (citing ID, 139 FERC ¶ 63,020 at P 51).

five percent of [El Paso's] total sustainable capacity legitimately may be characterized as 'unsubscribed.'"[988]

673. Indicated Shippers argue that the Presiding Judge failed to acknowledge that the record evidence shows that El Paso's future demand growth projections indicate approximately 2 Bcf of growth in natural gas demand in Mexico over the next 10 years. The Presiding Judge also failed to acknowledge the fact that El Paso's forecasts of future risks did not include 185,000 Dth/d in new long-term firm contracts to serve new demand in Mexico.[989] Finally, the Presiding Judge failed to consider El Paso's own statements that all pipelines face various competitive risks related to supply differentials, alternate fuels, alternate suppliers, etc.[990]

674. Moreover, Indicated Shippers argue that the Presiding Judge erred when he determined that "[El Paso's] high percentage of sculpted contracts . . . . materially increases [El Paso's] business risk."[991] This determination, according to Indicated Shippers, does not reflect the fact that El Paso's rates are designed on the average twelve-month level of the maximum daily quantity of the sculpted contracts, not the peak amount, so that there is not any additional risk to El Paso because of this characteristic. Indicated Shippers contend that at least half of the sculpted contracts are Article 11.2(a) contracts,[992] which they interpret as meaning that any associated risk was of El Paso's own making and that such contracts should therefore not be considered as a risk-creation factor.[993]

675. Both Trial Staff and Indicated Shippers argue that the Presiding Judge's finding that El Paso has anomalously high risk conflicts with his ruling that El Paso should not

[988] *Id.* at 13-14 (citing ID, 139 FERC ¶ 63,020 at P 269).

[989] *Id.* at 14 (citing Ex. IS-14 at 5, 28, 29, 39, and 40; Ex. IS-17 at 2; Tr. 909, line 21 to 910, line 14).

[990] *Id.* (citing Ex. S-41).

[991] *Id.* (citing ID, 139 FERC ¶ 63,020 at P 57).

[992] *Id.* (citing Ex. EPG-397).

[993] *Id.* (citing Opinion No. 517, 139 FERC ¶ 61,095 at P 238).

bear the risk of any costs attributable to excess capacity or discounted contracts.[994] For this reason, Indicated Shippers refer to El Paso's business risks as merely "theoretical."[995]

676. Indicated Shippers and Trial Staff argue that given El Paso's ability to recover the costs of unused capacity from maximum rate shippers, there is no basis to award El Paso an ROE higher than the median of the proxy group, even given some declining throughput.[996] Moreover, Trial Staff refers to the S&P report, which concluded that El Paso's recent decline in throughput was offset by the fact that its reservation charges account for 89 percent of capacity. Trial Staff reasons that there is considerable certainty regarding future cash flows because El Paso collects its reservation charges independent of throughput levels, and this is a positive for credit quality.[997]

677. Finally, Trial Staff states that if billing determinants and throughput do decline substantially, El Paso has the option, as does any pipeline, to file a new rate case to spread the costs of discounted and unsubscribed capacity across existing customers – an option El Paso has taken advantage of in the past and can continue to use in the future.[998]

Briefs Opposing Exceptions

678. El Paso argues that both Trial Staff and Indicated Shippers attempt to minimize the substantial business risks it faces. El Paso argues that it faces intense competition and short contract durations, which subject it to the risk of continuing degradation of its service and rate levels in the future.[999]

679. El Paso also contends that other parties are in error when they argue that the Presiding Judge's finding of anomalously high risks is in conflict with his refusal to require El Paso to bear the risks attributable to excess capacity or discounted contracts. According to El Paso, the position of these parties is premised on a mischaracterization of the "risk sharing" proposals in this case and evinces a misunderstanding of the risks that are compensated for in a pipeline's return on equity. In its view, the risk compensated for

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[994] Trial Staff Brief on Exceptions at 39 (citing ID, 139 FERC ¶ 63,020 at PP 263-275); Indicated Shippers Brief on Exceptions at 15.

[995] Indicated Shippers Brief on Exceptions at 15.

[996] *See, e.g.*, Trial Staff Brief on Exceptions at 39.

[997] Trial Staff Brief on Exceptions at 40 & n.102 (citing Ex. S-12 at 160).

[998] *Id.* at 39-40 & n.100.

[999] El Paso Brief Opposing Exceptions at 6.

in the rate of return includes the risk that after the rates are established, the pipeline will either not obtain the revenues its rates were designed to collect or its costs will increase.[1000]

680. In addition, El Paso argues that a regulated cost of capital addresses the after-the-fact risk that outcomes will vary from the expected, not the asymmetric up-front disallowance of prudent and legitimate costs, which cannot be fairly characterized as risk at all.[1001] The fact that El Paso could file a new rate case to reflect post-test period risks, such as additional discounting or contract terminations, would not permit it to recoup past losses. El Paso also argues that the ability to file a rate case does not minimize its relative risk compared to other proxy group companies, given that all pipelines have the same right to manage this risk.[1002]

681. El Paso contends that it faces anomalously high risks in the area it serves. El Paso claims that there is no dispute among the parties as to the following facts that affect its risk: (1) two of the four major pipelines competing with El Paso to serve California demand historically have lower commodity gas prices than the lowest cost San Juan supply basin accessed by El Paso; (2) Kern River Gas Transmission Company (Kern River) has recently doubled its capacity to California, which has displaced San Juan- and Permian-sourced gas transported by El Paso with cheaper Rocky Mountain sourced gas; (3) Transwestern has lower fuel costs and frequently dispatches first; (4) Gas Transmission Northwest Corporation and Kern River have some competitive advantage over El Paso in serving California; (5) Transwestern has a competitive advantage over El Paso in serving both California and Arizona; and (6) additional capacity could be added to competing pipelines at unit costs below the original pipelines' unit costs.[1003]

682. El Paso argues that, while its reservation rates may have been lower than other pipelines, the Presiding Judge found that reservation rates generally are not the most critical factor in the decision to acquire capacity. Rather, the Presiding Judge found that the more important fact is that El Paso's competitors can offer shippers access to a lower total cost of delivered gas. Because the transportation component of delivered gas is

[1000] *Id.* at 7.

[1001] *Id.* at 7-8 (citing Tr. 445-46 (Vilbert)).

[1002] *Id.* at 8.

[1003] *Id.* at 9-10.

relatively small compared to the cost of the commodity, El Paso contends that a pipeline's access to cheaper gas is paramount to its competitiveness.[1004]

683. El Paso agrees that the three-year contract length average did not change between September 2010 and September 2011. However, El Paso argues that significantly more contract quantities expired during the test period than it was able to add, resulting in a substantial net decrease in billing determinants over this period.[1005] In addition, regardless of how many expiring contracts were terminated or renewed in the recent past, El Paso remains at risk that its contracts may not be renewed or may be renewed for shorter terms or at lower rates in the future. El Paso notes that even the S&P report examines the duration of contracts as an indicator of business risk.[1006]

684. El Paso argues that the record shows that the recent economic downturn had a disproportionate impact on its market area. El Paso also argues that it faces substantial regulatory risks stemming from a relatively recent shift to a competitive paradigm by FERC, as well as by the ACC and the CPUC. This shift has encouraged competitive alternatives and supply diversity for customers and excess capacity in El Paso's historic markets. Further, El Paso argues that the fact that the Commission imposed sculpted contracts (that permit contract demands to vary by month) makes it difficult to sell its off-peak capacity, effectively strands long-term capacity, and increases the risk of unsubscribed and discounted capacity. Even though the Presiding Judge declined to require El Paso to absorb costs through a design under-recovery, it does not eliminate the continuing risk that sculpting creates after its rates are established.[1007]

685. Finally, El Paso contends that, contrary to Trial Staff's arguments, the credit analyst reports substantiate El Paso's high business risk. Among other things, El Paso argues that BB "is the credit rating for [El Paso] irrespective of whether it was affected by the credit ranking of [El Paso Corporation], and is lower than the ICRs [issuer credit ratings] of all the companies in the proxy group adopted by the [Presiding Judge]." El Paso also argues that Trial Staff's conversion of the BB rating to a stand-alone rating of BBB based on an S&P matrix is flawed because it examines only two factors and, in any

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[1004] *Id.*

[1005] *Id.* at 13 (citing Ex. EPG-377 at 2).

[1006] *Id.* at 13.

[1007] *Id.* at 15-16.

event, the same matrix analysis was not performed for the other companies in the proxy group.[1008]

Commission Determination

686. Based on its review of the record, the Commission reverses the Presiding Judge's finding that El Paso's relative risk justifies allowing it a ROE "well above" the median ROE of the proxy group companies.[1009] The Commission agrees with Trial Staff and Indicated Shippers that the Presiding Judge's relative risk analysis contains omissions and inaccuracies that undercut his ROE finding. In his relative risk analysis, the Presiding Judge addresses the two traditional components of total risk: financial risk and business risk. The Commission finds the risk analysis flawed and finds that El Paso's allowed ROE should be set at the median ROE of the proxy group companies – or 10.55 percent.

1. Financial Risk

687. Regarding financial risk, the Presiding Judge relied exclusively on S&P's financial risk scale, which ranks companies from 1 (minimal) to 6 (highly leveraged). S&P ranks El Paso as 5, which it characterizes as "aggressive." This compares to the average ranking of 4 (significant) for the Presiding Judge's recommended proxy group, which the Presiding Judge characterized as a "substantial" differential.[1010] Based solely on this differential, the Presiding Judge then found that El Paso's financial risk satisfies the "anomalously" high standard established by the Commission.[1011]

688. The Commission does not agree that this one-step difference on a six-step scale constitutes "highly unusual circumstances." The Commission places a heavy burden on those attempting to justify a deviation from the median ROE, and such limited evidence does not satisfy that burden. This is particularly true given Indicated Shippers' disclosure that S&P's "aggressive" rating was actually based on El Paso Corporation, the corporate parent of El Paso, and that the rating reflects, in part, higher risk exploration and

[1008] *Id.* at 16-18.

[1009] ID, 139 FERC ¶ 63,020 at P 63.

[1010] *Id.* P 61.

[1011] *Id.*

production activities.[1012] El Paso's stand-alone financial ratios are clearly viewed by S&P as stronger than El Paso Corporation's consolidated ratios.[1013]

689. Additionally, even though the most fundamental aspect of a company's financial risk is the amount of debt it carries,[1014] the Presiding Judge did not compare El Paso's debt ratio to the debt ratios of the proxy group companies. With respect to this issue, Trial Staff's witness determined that El Paso's ratemaking debt ratio was only slightly higher than the average debt ratio of the proxy group companies, thereby reflecting a slightly higher level of financial risk than the proxy group.[1015] Trial Staff also points out that, based on El Paso's test period equity ratio of 60 percent, *i.e.*, debt ratio of 40 percent, El Paso's own witness concluded that El Paso's financial risk is average compared to the proxy group companies.[1016] Indicated Shippers state that El Paso's witness agreed on cross-examination that El Paso had a lower level of financial risk than his proxy group companies.[1017]

690. The Presiding Judge failed to address the record evidence on El Paso's credit ratings when making his financial risk finding, relying exclusively on S&P's financial risk scale. While referencing El Paso's non-investment grade rating of BB by S&P, the Presiding Judge nonetheless recognized that this rating reflects the consolidated risk of El Paso's parent and that S&P considers El Paso's financial ratios on a stand-alone basis to be stronger.[1018] While the Presiding Judge acknowledged that Fitch gave El Paso a BBB-

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[1012] Indicated Shippers Brief on Exceptions at 10-11 (citing Ex. S-12 at 160).

[1013] Ex. S-12 at 160.

[1014] *See, e.g., Williams Natural Gas Co.*, 77 FERC ¶ 61,277, at 62,199 (1996) (a high equity ratio indicates a lower financial risk.); *see also Generic Determination of Rate of Return on Common Equity for Electric Utilities*, Notice of Proposed Rulemaking, FERC Stats. & Regs. ¶ 32,242, at 32,218 (1982) ("Financial risk is the uncertainty introduced by the method of financing an investment. It represents that portion of total company risk, over and above business risk, which results from using debt.")

[1015] Trial Staff Brief on Exceptions at 33-34 (citing Ex. S-10 at 35-36; Ex. S-11 at Schedule 15; Ex. S-25 at 2-3).

[1016] *Id.* (citing Ex. EPG-179 at 50).

[1017] Indicated Shippers Brief on Exceptions at 10 (citing Tr. 468:19-21; Tr. 477:17-479:8).

[1018] *Id.*

credit rating, he stated that this rating falls below the credit rating of all but one member of his recommended proxy group.[1019] In light of the fact that all the proxy group companies which have credit ratings are in the BBB (investment grade) category, and two of the five companies have no credit rating at all, such evidence does not support a finding of highly unusual circumstances.

691. In sum, El Paso's credit rating is at or very close to investment grade and very close to the average credit rating and/or range of credit ratings of those proxy group companies that have credit ratings. El Paso's debt ratio also reflects a level of financial risk that is about average compared to the proxy group companies. In addition, even though the Commission does not view a one-step differential on S&P's financial risk scale as constituting highly unusual circumstances, the Commission's view is further buttressed by the fact that this one step reflects, not just the operations of El Paso, but higher risk exploration and production activities that are not even part of El Paso's regulated business. Under these circumstances, the Commission is unable to conclude that a deviation from the median ROE is warranted because of anomalously high financial risk.

2. Business Risk

692. Trial Staff and Indicated Shippers address each of the areas analyzed in the Initial Decision regarding business risk and demonstrate why the conclusions reached are incorrect.[1020] As discussed above, they argue that in many cases the Presiding Judge failed to address relevant evidence in the record, in particular when rejecting information in S&P's reports regarding El Paso's business risk.[1021]

693. There are several deficiencies in the Presiding Judge's analysis of El Paso's business risk. Fundamentally, rate of return and risk go hand-in-hand: the higher the risk,

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[1019] *Id.* P 48.

[1020] Trial Staff Brief on Exceptions at 19-55; Indicated Shippers Brief on Exceptions at 10-16.

[1021] The Presiding Judge acknowledged the inconsistency between relying on S&P for his financial risk finding and ignoring it for his business risk finding, but justifies it because S&P's "excellent" business risk profile is contradicted by the record evidence. ID, 139 FERC ¶ 63,020 at P 58. However, as discussed here, the Commission, even on a qualitative basis, views the record evidence differently. Moreover, as noted *infra*, S&P's business risk profile considers many of the risk-increasing factors addressed in the Initial Decision, while also taking into account several risk-reducing factors, which El Paso and the Presiding Judge ignore.

the higher the required rate of return; the lower the risk, the lower the required rate of return. The key issue is whose risk perceptions are driving the rate of return. The only relevant risk perceptions are those of investors in the capital markets. While it is not possible to survey all investors in the market as to their risk perceptions regarding a specific company, the next best thing is to look to published investor services like S&P, which are likely relied on by investors when establishing their risk perceptions. By doing so, a nexus is established between risk and investors' required rate of return.

694. The conclusions regarding relative risk drawn by the qualitative analysis undertaken in the Initial Decision were not shown to reflect investors' risk perceptions nor was there an attempt to make such a showing. The Commission's DCF methodology is intended to estimate the market cost of equity capital by calculating the rate of return required by investors, which is a function of these investors' risk perceptions. Therefore, the Commission expects that an analysis attempting to show that a company's ROE should deviate from the proxy group's median ROE should, to the fullest extent possible, present evidence of investors' risk perceptions. If no such evidence is included in the record, it tends to make findings regarding relative risk more speculative.

695. S&P's report on El Paso, which characterized El Paso's business risk profile as "excellent," included consideration of many of the factors addressed by the Presiding Judge, which were adjudged to raise El Paso's risk level. Trial Staff states that the S&P report also considered several other factors, which it viewed as decreasing El Paso's risk level.[1022] In rejecting the S&P report, the Presiding Judge did not address this relevant evidence.

696. Trial Staff states that El Paso's risk is reduced by the fact that it operates under the fixed-variable rate design which allows it to recover 95 percent of its costs for mainline transmission service through its reservation rates without shipping a single dekatherm of gas.[1023] As with several other factors, the Presiding Judge did not weigh these risk-reducing features in his analysis. In addition, Trial Staff faults the Presiding Judge for blaming regulation for El Paso's excess capacity and discounting without evidence to support the charge. While Trial Staff acknowledges that the inability to fully market long-term capacity places more risk on El Paso, the Presiding Judge essentially neutralizes this risk by his ruling on this issue. As Trial Staff points out, "the Initial Decision held that [El Paso] should be fully insulated from the entire risk of unsubscribed

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[1022] *See, e.g.,* Trial Staff Brief on Exceptions at 32 (citing Ex. S-10 at 54-56; Ex. S-25 at 2-3; Ex. EPG-179 at 49-50).

[1023] Trial Staff Brief on Exceptions at 44.

capacity and discounted contracts and allocated those costs to [El Paso's] maximum rate customers."[1024]

697. This significant risk-reducing feature is essentially ignored by the Presiding Judge in his evaluation of El Paso's business risk. Indicated Shippers add that since the Presiding Judge allowed El Paso to design its rates in a way that avoids any of the risks from unsubscribed capacity and discounted rate contracts, any risks related to these factors become merely "theoretical."[1025] Indeed, the Commission affirms the Presiding Judge's ruling with respect to this rate design aspect, which greatly minimizes El Paso's business risk.[1026]

698. Finally, any analysis attempting to demonstrate that a deviation from the median ROE is justified must present a comparison between the risk level of the subject company and the risk level of each of the proxy group companies. This is the crux of the analysis, and if it is lacking, the analysis is incomplete. However, the record indicates that neither El Paso nor the Presiding Judge performed this analysis satisfactorily.[1027] This critical failing is sufficient, by itself, to reverse the Presiding Judge's ROE finding. Accordingly, for all of the above reasons, the Commission reverses the Presiding Judge's ROE finding and finds that El Paso's ROE should be set at the median ROE of the proxy group.

XI. Proposed Tariff Changes

699. The Initial Decision addressed five tariff changes proposed by El Paso. Three of those issues are discussed below (Stipulated Issues X.A (conditions to adding meters to D-Codes), X.D (conditions to the assignment of contracts), and X.E (automatic waiver of penalties during *force majeure* events)). The Commission summarily affirms the Initial Decision with respect to the remaining two issues (Stipulated Issues X.B and X.C).

[1024] *Id.*

[1025] Indicated Shippers Brief on Exceptions at 15.

[1026] This fact distinguishes the Commission's ROE finding here from the finding in the recent *Portland* case, where the Commission found justification for allowing a ROE at the high end of the range of reasonableness. In the *Portland* case, the company was placed at risk for unsubscribed capacity, whereas the Commission's ruling in this case insulates El Paso against this risk. Opinion No. 524, 142 FERC ¶ 61,197 at PP 207-220.

[1027] *See, e.g.*, Indicated Shippers Brief on Exceptions at 13 (citing ID, 139 FERC ¶ 63,020 at P 50, n.42; Ex. S-40); *see also* Trial Staff Brief on Exceptions at 53-55.

700. Stipulated Issue X.B addresses whether El Paso Electric met its NGA section 5 burden of demonstrating that El Paso's existing tariff concerning scheduling firm service is unjust and unreasonable. The Presiding Judge determined that this issue is moot in light of his analyses in other sections of the Initial Decision.[1028] No participant filed a brief on exceptions, and the Commission finds that the record in this proceeding supports the Presiding Judge's ruling.

701. Stipulated Issue X.C addresses whether El Paso's Third Party Charge tariff proposal, which permits El Paso to contract and charge for upstream or downstream off-system capacity, is just and reasonable. The Presiding Judge determined that El Paso had met its burden of proving that the proposal is just and reasonable.[1029] No participant filed a brief on exceptions, and the Commission finds that the record in this proceeding supports the Presiding Judge's ruling.

A. Addition of a New Meter to a D-Code (Stipulated Issue X.A)

702. El Paso voluntarily offers delivery point operators (who are often shippers) a nominating/scheduling flexibility option to aggregate multiple meters into a D-Code. A shipper choosing the D-Code option may take delivery at any delivery meter included in the D-Code. The D-Code option is offered under an Operator Point Aggregation Service Agreement (OPASA) pursuant to Rate Schedule OPAS.[1030] The tariff previously contained criteria for initially grouping meters into a new D-Code, but did not contain criteria for adding meters to an existing D-Code. El Paso proposed a five-condition tariff amendment to address this situation. The Commission permitted the tariff amendment to go into effect after suspension, but set it for hearing because various participants objected to one of the conditions. Condition E states as follows: "Transporter is not economically disadvantaged by the addition of the meter to the existing D-Code."[1031]

703. At hearing, Municipal Customers, Freeport/Apache, ACC/Southwest Gas, Texas Gas Service, and UNS/Tucson Electric argued that the condition is vague and overbroad because it does not define the term "economically disadvantaged." These parties further contended that the condition is unduly discriminatory because it would permit El Paso to deny D-code meter additions to shippers holding Article 11.2(a) contracts that allow them to take service at lower rates than non-Article 11.2(a) shippers. El Paso responded that

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[1028] ID, 139 FERC ¶ 63,020 at P 315.

[1029] *Id.* PP 316-318.

[1030] *Id.* P 311 (citing Ex. EPG-301 at 14-17).

[1031] *See id.* P 312.

the purpose of the condition is to permit it to deny a requested meter addition in cases in which the shippers otherwise would be required to pay an additional amount for service to the new meter if it were not added to the D-Code.[1032]

Initial Decision

704. The Presiding Judge found that the condition at issue is vague and overbroad in its current form and that El Paso should be required to define the term "economically disadvantaged" in its tariff to address any specific circumstances intended to be covered by the provision. He stated that any proposed modification to this provision should be included in El Paso's Brief on Exceptions.[1033]

705. Additionally, the Presiding Judge concluded that the condition, as modified, will not be unduly discriminatory because it will afford Article 11.2(a) shippers and non-Article 11.2(a) shippers identical treatment.[1034] He interpreted the claim of the Article 11.2(a) shippers as arguing that they will experience undue discrimination because the condition will not unduly discriminate in their favor. In his view, that argument conflates transportation/capacity rights with D-Code scheduling/operational flexibility. The Presiding Judge explained that Article 11.2(a) shipper transportation/capacity rights are specified in their Article 11.2(a) contracts and are fixed.[1035] The Presiding Judge further explained that Article 11.2(a) shipper D-Code flexibility is offered under separate OPASAs and that an Article 11.2(a) shipper's OPASA grants it the scheduling/operational flexibility to take delivery at any initially-designated D-Code meter. The Presiding Judge stated that the Article 11.2(a) shippers' OPASAs now also grant those shippers the option to add meters to previously-established D-Codes to further enhance that flexibility. The Presiding Judge observed that this new option only provides additional scheduling/operational *flexibility*, and it does not provide additional Article 11.2(a) transportation/capacity rights. The Presiding Judge emphasized that any proposed meter addition(s) to an existing D-Code cluster that would enhance an Article 11.2(a) shipper's transportation/capacity rights also would require the shipper to amend its TSA with El Paso because the enhanced transportation/capacity rights would not be

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[1032] *Id.* P 312.

[1033] *Id.* P 313.

[1034] *Id.* P 314 (citing Ex. EPG-301 at 23).

[1035] *Id.* P 314 n.282. The Presiding Judge stated that he did not accept El Paso's suggestion that Article 11.2(a) contracts are "discount" contracts. Rather, he stated, they are a unique set of maximum (settlement) rate contracts (citing, *e.g.*, Tr. 1157).

covered by Article 11.2(a).[1036] Absent this, stated the Presiding Judge, the pipeline would be providing capacity to the Article 11.2(a) shipper at Article 11.2(a) rates which El Paso otherwise could sell at market rates. The Presiding Judge concluded that El Paso would be "economically disadvantaged" by this and that it also would be providing unduly preferential service to the Article 11.2(a) shipper.[1037]

Briefs on Exceptions

706. El Paso argues that the Presiding Judge erred by finding the phrase "economically disadvantaged" vague and overbroad. It contends that its witness Stires cited situations in which the addition of a meter to a Delivery Point Operator's D-Code could economically harm El Paso by effectively allowing a shipper to use the D-Code flexibility to avoid the payment of charges that would otherwise apply.[1038] El Paso does not object to using the term "financially indifferent," as the Commission has routinely allowed for tariff provisions that provide pipelines with discretion to refuse to relieve a shipper from liability through a permanent capacity release unless the pipeline is "financially indifferent" to the release.[1039]

707. ACC/Southwest Gas, Municipal Customers, Freeport, Texas Gas Service, and UNS/Tucson Electric argue that the Presiding Judge erred in accepting El Paso's proposed tariff changes relating to D-Codes and directing the pipeline to define "economically disadvantaged" more specifically in its Brief on Exceptions so that the Commission can determine whether El Paso's revised provision will be unduly discriminatory.[1040] These participants contend that the Presiding Judge's direction effectively renders moot any comments participants may submit addressing El Paso's yet-to-be-filed definition, observing that NGA section 4 places the burden on El Paso to demonstrate that all aspects of its tariff filing are just and reasonable and not unduly

[1036] *Id.* P 314 (citing Opinion No. 517, 139 FERC ¶ 61,095 at PP 243, 251).

[1037] *Id.* (citing Ex. EPG-301 at 23).

[1038] El Paso Brief on Exceptions at 146-48 (citing Ex. EPG-301 at 21-27).

[1039] *Id.* at 148-49 (citing *Northern Border Pipeline Co.*, 127 FERC ¶ 61,180, at PP 4-5 (2009) (*Northern Border*); *Northwest Pipeline Corp.*, 111 FERC ¶ 61,231, at PP 17, 25 (2005) (*Northwest III*); *Algonquin Gas Transmission, LLC*, 112 FERC ¶ 61,262 (2005)).

[1040] Municipal Customers Brief on Exceptions at 19; Freeport Brief on Exceptions at 5; ACC/Southwest Gas Brief on Exceptions at 134; Texas Gas Service Brief on Exceptions at 75; and UNS/Tucson Electric Brief on Exceptions at 27-28.

discriminatory.[1041] Municipal Customers claim that the Presiding Judge is authorized only to accept, reject, or modify El Paso's proposal, but not to offer El Paso a post-hearing opportunity to modify its proposal after the hearing record has closed.[1042] Texas Gas Service asserts that the Commission should reverse the Presiding Judge, reject El Paso's proposed D-Code provisions, and find that the Presiding Judge's novel proposal to allow El Paso to modify its proposal in its brief on exceptions constitutes legal error; if the Commission affirms the Presiding Judge's finding that the provision is "vague and overbroad," El Paso can submit in a new proceeding a modified proposal and/or seek rehearing and potentially judicial review.[1043]

708. Municipal Customers, Freeport, Texas Gas Service, and UNS/Tucson Electric further argue that the term "economically disadvantaged" is an attempt to curtail the rights of Article 11.2(a) shippers, contrary to the Commission's reaffirmation in Opinion No. 517. They argue El Paso can use this condition to selectively bar only Article 11.2 shippers from adding additional meters to existing D-Codes and using their existing Article 11.2 capacity more efficiently.[1044] Freeport and Texas Gas Service point out that El Paso considers the addition of any meter to a D-Code held by an Article 11.2(a) shipper to be economically disadvantageous to it unless the shipper agrees to instead take service at the new meter at the applicable recourse rate, not at the applicable Article 11.2(a) rate.[1045]

709. These participants also argue that use of Article 11.2(a) service at different meters does not increase El Paso's economic exposure or result in unduly preferential service to Article 11.2(a) shippers, but allows Article 11.2(a) shippers to use existing Article 11.2(a) capacity in a more efficient manner in accordance with the Commission's flexible point

[1041] Municipal Customers Brief on Exceptions at 19; Texas Gas Service Brief on Exceptions at 76; UNS/Tucson Electric Brief on Exceptions at 28; Freeport Brief on Exceptions at 8 (citing 18 C.F.R. § 154.301(c)).

[1042] Municipal Customers Brief on Exceptions at 20.

[1043] Texas Gas Service Brief on Exceptions at 76-77.

[1044] Municipal Customers Brief on Exceptions at 20; Freeport Brief on Exceptions at 6; Texas Gas Service Brief on Exceptions at 75; and UNS/Tucson Electric Brief on Exceptions at 27 (citing the ID, 139 FERC ¶ 63,020 at P 313).

[1045] Freeport Brief on Exceptions at 7 (citing Ex. 404 at 33:19-34:2); Texas Gas Service Brief on Exceptions at 75 (citing Ex. EPG-206 at 34:1-3).

policies.[1046] They contend that this condition is thus unduly discriminatory to a shipper that is merely seeking to use its Article 11.2(a) capacity more efficiently, without any expansion of capacity rights.[1047]

Briefs Opposing Exceptions

710. El Paso asserts that Texas Gas Service's procedural argument that the Presiding Judge's ruling deprives it of the right to conduct discovery and build a record on the proposal is meritless. El Paso points out that the Commission routinely rules on proposed tariff changes under NGA section 4 without any hearing at all. El Paso further maintains that further definition of "economically disadvantaged" will not change the substance of the Presiding Judge's ruling.[1048]

711. El Paso asserts that D-Codes never were intended to permit shippers to avoid paying higher rates that might otherwise apply to service to new points.[1049] El Paso explains that it has been voluntarily providing administrative and scheduling flexibility and that this flexibility should not permit Article 11.2 shippers to avoid paying higher rates than would otherwise apply.[1050] El Paso adds that the Commission has held that D-Codes provide flexibility, but are not a contract right.[1051] El Paso states that if it loses revenues due to the flexibility provided by D-Codes, then other shippers will bear the cost of the lost revenues in future rate cases.

712. Freeport/Apache/Municipal Customers, ACC/Southwest Gas, and Texas Gas Service argue that El Paso's proposed phrase "financially indifferent" is as deficient as "economically disadvantaged."[1052] They contend that El Paso only provides examples of

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[1046] Texas Gas Service Brief on Exceptions at 77-78; UNS/Tucson Electric Brief on Exceptions at 28; Freeport Brief on Exceptions at 6.

[1047] Texas Gas Service Brief on Exceptions at 78-79; UNS/Tucson Electric Brief on Exceptions at 28.

[1048] El Paso Brief Opposing Exceptions at 169-70.

[1049] *Id.* at 170 (citing Ex. EPG-404 at 30-34).

[1050] *Id.* (citing Ex. EPG-301 at 20:14-19).

[1051] *Id.* (citing *El Paso Natural Gas Co.*, 121 FERC ¶ 61,266, at P 26 (2007)).

[1052] Freeport/Apache/Municipal Customers Brief Opposing Exceptions at 3; ACC/Southwest Gas Brief Opposing Exceptions at 66; and Texas Gas Service Brief Opposing Exceptions at 89.

the types of events that it believes could cause it to be "economically disadvantaged" rather than defining that term or enumerating the specific circumstances as the Presiding Judge directed.

713. Texas Gas Service and ACC/Southwest Gas argue that the term "financially indifferent" would still allow El Paso to refuse Article 11.2 shippers' requests to add meters based on El Paso's interpretation of the "financially indifferent" standard. These parties assert that the Commission should reject El Paso's proposed D-Code meter condition because the addition of a meter to an existing D-Code would not enhance Article 11.2(a) shippers' transportation and capacity rights, inasmuch as their maximum daily contract quantities would not be affected.[1053] Alternatively, ACC/Southwest Gas ask the Commission to find that approval of the tariff language does not constitute pre-approval of El Paso's interpretation of the "financially indifferent" condition so that it could deny a future meter addition by an Article 11.2 shipper.[1054]

714. Competitive Power Suppliers raise the same objection advanced by Texas Gas Service and ACC/Southwest Gas.[1055] Competitive Power Suppliers add that the Article 11.2(a) rate is 56 percent lower than the recourse rate ($13.7307 Dth/month while Article 11.2(a) shippers pay $8.7622 Dth/month) and that it is unconscionable for the Article 11.2(a) shippers to claim that they will suffer undue discrimination if they are not afforded unduly preferential rate treatment for service to new meters. Competitive Power Suppliers point out that Article 11.2 is limited to "the rates for service to any shipper that has a TSA that was in effect on December 31, 1995 and remains in effect, in its present form or as amended, on January 1, 2006."[1056] Competitive Power Suppliers urge the Commission to deny what they characterize as an attempt to expand the load that receives these preferential rates.[1057]

[1053] Texas Gas Service Brief Opposing Exceptions at 89-90; ACC/Southwest Gas Brief Opposing Exceptions at 68, 72-73.

[1054] ACC/Southwest Gas Brief Opposing Exceptions at 68-73.

[1055] Competitive Power Suppliers Brief Opposing Exceptions at 17-18.

[1056] Competitive Power Suppliers Brief Opposing Exceptions at 19 (citing Article 11.2 of the 1996 Settlement).

[1057] *Id.*

Commission Determination

715. The Commission affirms the Presiding Judge's ruling that Condition E is vague and overbroad. The Commission finds, moreover, that El Paso's proposed use of "financially indifferent" to replace "economically disadvantaged" will not remove ambiguity in the provision. While the Commission has found that it is reasonable for a pipeline to refuse a permanent capacity release if it has a reasonable basis to conclude that it will not be financially indifferent to the release,[1058] the "financially indifferent" standard is not commonly used in other tariff provisions. In the instant tariff proposal, the Commission considers "financially indifferent" to be functionally similar to "economically disadvantaged" and thus equally vague and overbroad. Limiting the addition of meters to those to which El Paso would be "financially indifferent" provides El Paso too much discretion as to when to grant a shipper's request to aggregate multiple meters into a D-Code and therefore is not just and reasonable.

716. A pipeline's agreement to a permanent capacity release entails the pipeline agreeing to the early termination of a releasing shipper's service agreement before the end of its term. As explained in *Northwest*, it is not practical to set out in the pipeline's tariff every extenuating circumstance or condition that would provide a reasonable basis for the pipeline to refuse to relieve the releasing shipper from liability under its contract. However, El Paso has not shown the need for such flexibility with respect to the addition of a meter to a D-Code. We agree that El Paso has sufficiently demonstrated that it is just and reasonable to limit the addition of a meter, if that addition would allow the shipper to pay a lower rate for service to that meter than the otherwise applicable rate. However, there does not appear any reason why El Paso cannot set forth in its tariff the specific circumstances when the addition of a meter would have this effect. El Paso's Witness Stires described situations in which the addition of a meter to a D-Code could allow a shipper to (1) avoid payment of charges that otherwise would apply, including out-of-zone charges; or (2) extend a discounted rate or an Article 11.2 rate to a meter that otherwise would not be subject to a discounted rate or an Article 11.2 rate. Accordingly, the Commission rejects El Paso's proposed Condition E, without prejudice to El Paso making a new proposal in another docket addressing the concerns discussed above.

717. Article 11.2(a) shippers maintain that their rates are maximum rates, as are recourse rates, and, therefore, they should be allowed to add meters to D-codes without

[1058] *See Northern Border*, 127 FERC ¶ 61,180 at PP 4-5; *Northwest III*, 111 FERC ¶ 61,231 at PP 17, 25.

limitation. However, El Paso is not proposing to change the ability of shippers to use alternate delivery points pursuant to the underlying Rate Schedule FT-1 contracts.[1059] Instead, El Paso is modifying Rate Schedule OPAS, which is a free service that El Paso provides to its shippers to allow them to aggregate delivery meters into a D-Code to simplify contracting, nomination, and allocation procedures. As the Presiding Judge explained:

> [T]his new option only provides additional scheduling/operational *flexibility*. It does not provide additional Article 11.2(a) transportation /capacity rights. Any proposed meter addition(s) to an existing D-Code cluster that would enhance an Article 11.2(a) shipper's transportation/capacity rights also would require the shipper to amend its TSA with [El Paso] because the enhanced transportation/capacity rights would not be covered by Article 11.2(a). Absent this, the pipeline would be providing capacity to the Article 11.2(a) shipper at Article 11.2(a) rates which [El Paso] otherwise could sell at market rates.[1060]

718. The Article 11.2(a) shippers assert that the ability to add meters to a D-Code is not an enhancement of transportation/capacity rights because their rates, while lower than other shippers' rates, are their "recourse rates." Nevertheless, these lower rates, if extended through D-Code meter additions to areas not covered by their existing TSAs, would effectively extend the Article 11.2(a) shippers' access to service beyond their existing capability under their TSAs, and would hinder El Paso's ability to sell that increment of service at maximum recourse rates. The Commission concludes that it is not unduly discriminatory to approve Condition E, if modified as described above, so as to limit it to certain circumstances.

719. The Commission finds that El Paso's intention is to establish reasonable limitations to the OPAS service which it voluntarily provides to shippers at no charge. It simply has not spelled out the particular situations where a limitation would be reasonable, but rather has attempted to impose a blanket standard of "financial indifference" that might sweep too broadly. Condition E, so limited, would not unduly

[1059] The rate applicable to the use of flexible points is governed by section 8.1(g) of El Paso's GT&C, which provides that a shipper must pay the higher of the maximum rate applicable to the original delivery point or the maximum rate applicable to the zone for which service is provided, unless El Paso agrees to discount such rates.

[1060] ID, 139 FERC ¶ 63,020 at P 314 (citing Opinion No. 517, 139 FERC ¶ 61,095 at PP 243, 251 (reference omitted)).

discriminate against Article 11.2(a) shippers, because it would apply to all shippers with OPAS contracts. All discounted contracts and all contracts extended out of zone would be similarly affected by a modified Condition E whether the movement was under an Article 11.2 contract or not. El Paso correctly asserts that ensuring that it is financially indifferent to new meter additions protects shippers whose rates ultimately would increase as a result of lower system revenues without contravening Article 11.2.[1061]

720. Some participants challenge the Presiding Judge's decision to permit El Paso to modify Condition E in its Brief on Exceptions. The Commission finds that interested parties will have sufficient opportunity to comment if El Paso makes a filing in a separate docket to propose a modified Condition E to limit the meter addition condition to particular circumstances.

721. Accordingly, the Commission rejects El Paso's proposed Condition E without prejudice to El Paso a new proposal in another docket to address the concerns discussed above.

B. Assignment of Transportation Contract Rights (Stipulated Issue X.D)

722. Commission policy established in Order Nos. 636 and 636-A requires capacity assignments to be made in accordance with tariff-specified capacity release procedures.[1062] The only exceptions to this requirement cover capacity assignments made in connection with the acquisition of all or essentially all of an entity's business or assets or as security for bonds or other obligations or securities.[1063] El Paso's current tariff reflects these capacity release procedures and exceptions. El Paso proposes to add a condition to the exceptions specified in the tariff that would limit assignments to entities that would leave El Paso "financially indifferent" to the assignment.[1064]

[1061] *See* El Paso Brief on Exceptions at 147-48.

[1062] Order No. 636, FERC Stats. & Regs. ¶ 30,939, *order on reh'g*, Order No. 636-A, FERC Stats. & Regs. ¶ 30,950.

[1063] *See, e.g.*, *Cheyenne Plains Gas Pipeline Co., L.L.C.*, 110 FERC ¶ 61,326, at P 3 (2005) (*Cheyenne*).

[1064] ID, 139 FERC ¶ 63,020 at P 320 (citing Ex. EPG-301 at 12) (Rebuttal testimony of Susan C. Stires, explaining that El Paso proposes to modify its proposed tariff language to apply the "financially indifferent" condition to both exceptions).

723. El Paso's tariff proposal, as modified in the hearing in this proceeding, is as follows:[1065]

> 4.20 Assignments
>
> (a) Assignable Parties. *If Transporter is financially indifferent,* a Shipper may assign its TSA to:
>
> > (i) any person, firm, or corporation acquiring all, or substantially all, of the natural gas business of said Party;
> >
> > (ii) a trustee or trustees, individual or corporate, as security for bonds or other obligations or securities; but it may not be otherwise assigned without the consent of the other Party hereto. Whenever any corporation is referred to herein, such reference shall be deemed to include the successors and assignees of such corporation.
>
> (b) If a Shipper wishes to assign a portion or all of its firm capacity under a TSA to a party not described above, it must do so using the capacity release provisions of this Tariff.

724. At hearing, El Paso argued that the proposed condition simply clarifies "that the existing list of assignable parties must be creditworthy and that [El Paso] must be financially indifferent to the assignment."[1066] El Paso explained that the "financially indifferent" requirement will ensure that it will not be in a worse financial position subsequent to the assignment and/or that the assignment will not impact its ability to finance its pipeline.[1067]

725. Rate Protected Shippers contended that El Paso has not satisfied its burden to prove that the proposed condition is just and reasonable. They contended that by extending the condition beyond the assignee's creditworthiness, El Paso is attempting to

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[1065] *See* Ex. EPG-301 at 11-12 (emphasis added to indicate proposed tariff language).

[1066] ID, 139 FERC ¶ 63,020 at P 320 (citing Ex. EPG-301 at 13).

[1067] *Id*. (citing Ex. EPG-206 at 25).

prevent assignment of Article 11.2(a) contracts. For that reason, Rate Protected Shippers claimed that the proposal will be unduly discriminatory.

Initial Decision

726. The Presiding Judge stated that, although Rate Protected Shippers did not raise the issue, the proposed "financially indifferent" condition is vague and overbroad in its current form. If the Commission were to accept the condition in principle, the Presiding Judge recommended that El Paso should be required to define the term in the tariff provision. Noting El Paso's claim that the proposed condition is intended to ensure that it will not "be in a worse financial position subsequent to the assignment,"[1068] the Presiding Judge observed that this is a common contract standard. Further, stated the Presiding Judge, if this standard is adequate for El Paso's purposes, it should be reflected in the condition. If not, continued the Presiding Judge, El Paso should add language that is more precise than "have impacts on [El Paso's] ability to finance its pipeline." The Presiding Judge further stated that the modified condition should be included in El Paso's Brief on Exceptions so that the Commission can evaluate whether it is sufficiently clear, specific, and otherwise just and reasonable.[1069]

727. The Presiding Judge also found that whether a contract such as a TSA generally may be assigned—and under what conditions—is a matter of general contract law. He stated that absent an express prohibition, a contract may be assigned, and absent conditions, it may be assigned unconditionally. The Presiding Judge concluded that the record in this proceeding does not indicate that the Article 11.2(a) TSAs reflect any assignment prohibition or conditions, and the only applicable assignment limitations are reflected in El Paso's tariff. The Presiding Judge explained that those limitations specify to whom and for what purposes an Article 11.2(a) TSA may be assigned, but the tariff does not specify any assignment-limiting *conditions*.[1070] The Presiding Judge further stated that although the record does not support the Rate Protected Shippers' claim that the "financially indifferent" condition would unduly discriminate against Article 11.2(a) shippers by singling them out, it clearly would cover their TSAs.[1071] In other words, continued the Presiding Judge, the condition essentially would abrogate the Article

[1068] *Id.* P 322 (citing Ex. EPG-206 at 25).

[1069] *Id.* (stating that this procedure also will permit other participants to address the modified condition in their Briefs Opposing Exceptions).

[1070] *Id.* P 323 (stating that the tariff requires El Paso's prior written consent, which may not be unreasonably withheld).

[1071] *Id.* (citing Tr. 1154-62).

11.2(a) TSAs insofar as the agreements' inherent assignment rights are implicated. However, the Presiding Judge observed that the Commission repeatedly has rejected El Paso's entreaties to abrogate Article 11.2, most recently in Opinion No. 517.[1072]

728. Finally, the Presiding Judge stated that the proposed assignment condition is simply an indirect attempt by El Paso to be relieved of a continuing consequence of its 1996 Settlement bargain. Accordingly, the Presiding Judge concluded that while an appropriately modified condition would not be unduly discriminatory, it nevertheless would be unjust and unreasonable.[1073]

Briefs on Exceptions

729. El Paso argues that the Presiding Judge erred by rejecting its proposal to modify its tariff to require that contract assignments leave it financially indifferent. El Paso states that Commission policy requires assignments of capacity to be accomplished through the capacity release provisions of a pipeline's tariff,[1074] with only two exceptions: (a) assignments made in connection with acquisitions of essentially all of a party's assets, or (b) as security for bonds or other obligations or securities.[1075] El Paso states that, like most pipelines, it has a tariff provision providing for these types of contract assignments outside of the capacity release rules.[1076]

[1072] *Id.* (citing Opinion No. 517, 139 FERC ¶ 61,095 at PP 232, 235, 238). In P 238, the Commission stated as follows:

> The fact that [El Paso's] bargain turned out favorably for some Parties (and less favorably for others) once the risks became known is not an indication of an inequitable bargain, or grounds for negating remaining obligations. It is well established that a company is not typically entitled to be relieved of its improvident bargain (footnotes omitted).

[1073] ID, 139 FERC ¶ 63,020 at P 323 & n.285 (stating that it would be unnecessary to the extent El Paso's larger concern over leveraging Article 11.2(a) rights to create Article 11.2(b) rights is a motivating factor). *See* discussion of Stipulated Issue IX.H *supra*.

[1074] El Paso Brief on Exceptions at 149 (citing *Northern Border*, 127 FERC ¶ 61,180 at P 5; *Northwest III*, 111 FERC ¶ 61,231 at P 25).

[1075] *Id.* at 150 (citing *Cheyenne*, 110 FERC ¶ 61,326 at P 3).

[1076] *Id.* (citing Ex. EPG-301 at 10 (citing El Paso GT&C Section 4.20) and similar provisions in other pipeline tariffs attached at Ex. EPG-302).

730. El Paso asserts that its proposal to condition contractual assignments on its financial indifference is no different than other Commission-approved proposals made in the context of permanent capacity releases.[1077] El Paso contends that in *Texas Eastern*, the Commission held that a pipeline is required to relieve a shipper of liability under its contract through a permanent release only if the pipeline is financially indifferent. According to El Paso, if the replacement shipper is not as strong financially as the original shipper, the pipeline would not be financially indifferent to the release, and therefore would not be required to allow it. El Paso emphasizes that its tariff includes the "financially indifferent" standard in its capacity release tariff provisions,[1078] and that it proposes to apply the same standard to the parallel assignment provision.

731. El Paso states that the Presiding Judge performed a similar analysis of the term "financially indifferent" in evaluating El Paso's proposed modification regarding D-Codes. That analysis is addressed earlier in this order.[1079] According to El Paso, although the Presiding Judge first found that the phrase was vague and overbroad, he ultimately concluded that this flaw could be cured by the addition of a provision that would define the condition allowing El Paso to deny an assignment if it would place El Paso in a worse financial position following the assignment, comparable to the Commission's rulings in other cases.[1080]

732. El Paso next states that the Presiding Judge found the provision to be unjust and unreasonable because (a) it would abrogate Article 11.2(a) contracts insofar as the agreements' inherent assignment rights are implicated, and (b) contracts generally may be assigned as a matter of general contract law, absent an express prohibition. El Paso emphasizes that, although the Presiding Judge found that the Article 11.2 TSAs were not in the record of this proceeding, he nevertheless concluded that the proposed limitation would effectively abrogate the Article 11.2(a) contracts.[1081]

[1077] *Id.* (citing *Texas Eastern Transmission Corp.*, 82 FERC ¶ 61,118 (1998), *order on reh'g*, 83 FERC ¶ 61,092, at 61,448 (1998) (*Texas Eastern*)).

[1078] *Id.*

[1079] *See* section addressing Stipulated Issue IX.A, *supra*.

[1080] El Paso Brief on Exceptions at 151 (citing ID, 139 FERC ¶ 63,020 at P 322; *see also Northern Border*, 127 FERC ¶ 61,180 at PP 4-5; *Northwest III*, 111 FERC ¶ 61,231 at PP 17, 25).

[1081] *Id.* (citing ID, 139 FERC ¶ 63,020 at P 323).

733. El Paso challenges the Presiding Judge's ruling. First, states El Paso, the Commission only permits assignments of such contracts in limited circumstances. El Paso observes that the Presiding Judge acknowledged that contracts may be assigned only to an entity acquiring all or almost all of the gas business of the assignor or to an entity for financing purposes,[1082] but in other situations, the shippers must rely on the capacity release procedures of the pipeline's tariff.[1083] El Paso maintains that the Presiding Judge erred in ruling that transportation contracts generally are assignable.

734. Second, continues El Paso, the Presiding Judge's conclusion that El Paso's proposal to limit the assignability of contracts is an abrogation of the contracts fails to recognize that the Commission has allowed a similar restriction on assignments under the capacity release program. El Paso asserts that the Commission already allows pipelines to limit shippers' ability to make permanent releases.

735. Third, states El Paso, the Presiding Judge provides no authority for his ruling that contracts are freely assignable pursuant to general contract law. El Paso contends that certain parties, and apparently the Presiding Judge, rely on the Restatement (Contracts) § 317 (1981), but El Paso contends that in so doing, the Presiding Judge and those parties base their positions on a selective portion of that section of the Restatement.[1084] El Paso argues that its proposal follows settled contract assignment law.

736. Fourth, states El Paso, the Presiding Judge has confused the relationship of its TSAs and its tariff. According to El Paso, such agreements, including its own,

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[1082] *Id.* (citing ID, 139 FERC ¶ 63,020 at P 319, in which the Presiding Judge cited *Cheyenne*, 110 FERC ¶ 61,326 at P 3).

[1083] Citing *Algonquin Gas Transmission Co.*, 59 FERC ¶ 61,032, at 61,095-96 (1992)).

[1084] El Paso states that the relevant portion of that section provides as follows:

> A contractual right can be assigned *unless* the substitution of a right of the assignee for the right of the assignor *would materially change the duty of the obligor*, or *materially increase the burden or risk imposed on him by his contract*, or materially impair his chance of obtaining return performance, or *materially reduce its value to him*. . .

El Paso Brief on Exceptions at 153 & n.205 (citing Restatement (Second), § 317(2)(a) (emphasis added)); *see also* U.C.C. § 2-210(2)).

incorporate the general terms and conditions of a pipeline's tariff.[1085] According to El Paso, its TSAs include a *Memphis* clause, which affords it the right to propose changes to its rates and terms of service and that the TSAs will be deemed to include any such changes accepted by the Commission.[1086] Thus, argues El Paso, a change to the assignment provision in its tariff does not "abrogate" El Paso's TSAs because the TSAs themselves incorporate and contemplate changes to the tariff. Additionally, El Paso asserts that the Commission previously has rejected a similar argument that allowing shippers to segment capacity outside their primary path impermissibly modified the pipeline's contracts with its shippers:

> [Florida Gas Transmission Company's] contention that the Commission's action erroneously modifies transportation contracts in violation of the *Mobile-Sierra* doctrine is without merit. As discussed above, the Commission has not modified the shippers' contracts. It has simply acted under NGA Section 5 to modify the terms and conditions in the tariff, which are automatically incorporated in the parties' contracts.[1087]

737. El Paso reiterates that its proposed revision does not abrogate shippers' rights under their contracts. El Paso asserts that the Presiding Judge's reliance on the fact that El Paso's existing tariff does not *currently* contain any assignment-limiting conditions misses the point that El Paso is contractually entitled to propose a change to its tariff, which should be approved if found to be just and reasonable.

Briefs Opposing Exceptions

738. UNS/Tucson Electric argue that the Presiding Judge correctly found that El Paso's proposal to apply the "financially indifferent" criteria to assignments (as opposed to permanent capacity releases) is unjust and unreasonable. They state that while it is Commission policy to permit such a condition in permanent capacity releases, the

[1085] *Id.* at 153 (citing El Paso's Form of Service Agreement at Part V of its FERC NGA Gas Tariff).

[1086] *Id.* (citing, *e.g.*, section 13 of the Form of Service Agreement applicable to Rate Schedule FT-1).

[1087] *Id.* at 154 (citing *Florida Gas Transmission Co.*, 106 FERC ¶ 61,160, at P 18 n.11 (2004)).

Commission never has allowed, nor has it been asked to allow, such a condition in a general capacity assignment.[1088]

739. UNS/Tucson Electric points out that the Commission permits a "financially indifferent" condition in permanent capacity releases because the capacity release provisions have a "workaround" solution if the pipeline is not financially indifferent to the release.[1089] However, continue UNS/Tucson Electric, there is no such safety valve in El Paso's assignment proposal that would provide a work-around solution if El Paso determined that it was not financially indifferent to a general assignment. In fact, state UNS/Tucson Electric, El Paso's proposal could afford it the opportunity to scuttle a shipper's sale of its entire natural gas business by refusing to consent to an assignment and by requiring the posting and bidding of the capacity, potentially negating any benefits of a negotiated or settled rate for the entire contract portfolio of the assigning shipper.

740. UNS/Tucson Electric contend that El Paso misinterprets the section of the Restatement (Contracts) addressing assignments; they also point out that unlike a permanent release of capacity, which dissolves the releasing shipper's agreement, a general assignment would not increase El Paso's risks and burdens because the terms and conditions of an assigned transportation agreement remain unchanged by an assignment.[1090]

Commission Determination

741. The Commission affirms the Initial Decision on this issue. No other pipeline has inserted the "financially indifferent" requirement into shippers' assignment transactions, and the condition would not serve the same purpose for which the Commission permits it with respect to permanent capacity releases. El Paso has not shown that its novel approach is just and reasonable.

[1088] UNS/Tucson Electric Brief Opposing Exceptions at 18-19 & n.8. UNS/Tucson Electric assert that El Paso did not cite a single other pipeline with assignment language similar to El Paso's proposal here. In fact, UNS/Tucson Electric contend that El Paso's Witness Stires admitted that she did not research other pipelines' tariffs to ascertain whether any other pipeline's tariff contains language similar to El Paso's proposal.

[1089] *Id.* at 19 (citing *El Paso Natural Gas Co.*, 113 FERC ¶ 61,281, at P 15 (2005) ("there is no restriction on the release of capacity, only reasonable restrictions on the release of shippers from their contract liabilities")).

[1090] *Id.* at 20.

742. El Paso's proposal would permit it to refuse to consent to an assignment of a shipper's contract in two circumstances: when the assignment is made as part of the shipper's sale of all or substantially all of its natural gas business or assets to another entity or as security for bonds or other obligations or securities. UNS/Tucson Electric correctly point out that the proposal could grant El Paso discretion to block a shipper's sale of its entire natural gas business by refusing to consent to an assignment of the shipper's transportation contracts to the purchaser of its business.

743. While El Paso asserts that its proposal is consistent with general contract law, it has cited only section 317 of the Restatement (Contracts) and U.C.C. § 2-210(2) for this proposition. However, those materials only describe generally the rights of a party to a contract to refuse to consent to its assignment to another entity. They do not address contract assignment rights in the context of one party's sale of its business or as security for bonds. Both these situations would appear to involve special considerations not applicable in other assignment situations. For example, a corporation's sale of its business could lead to its inability to continue to perform under the contract. In fact, such a sale could occur as part of the dissolution of the corporation. The materials cited by El Paso do not address the rights of other parties to the contract to refuse to consent to assignment of a contract in such a situation. Moreover, El Paso's forms of service agreement provide that contract disputes will be decided based on the law of the State of Colorado.[1091] El Paso has made no effort to show that its proposal is consistent with Colorado contract law concerning the assignability of contracts in the context of a sale of a business or as security for a bond. El Paso has thus not provided the Commission sufficient information to determine whether its proposal would be consistent with applicable Colorado contract law, without conducting our own legal research into this matter. Given that El Paso has the burden under NGA section 4 to support its proposal, the Commission is not willing to undertake a burden El Paso should have shouldered.

744. The Commission is not in a position to determine the justness and reasonableness of El Paso's proposal, without knowledge as to its consistency with applicable contract law. While we do not currently see a reason to require El Paso to consent to an assignment of a contract in these two contexts if such consent would not be required under applicable contract law, we similarly do not see a reason why we should permit El Paso to impose more stringent conditions than permitted under applicable contract law. For all that appears on the current record, El Paso's proposal could do the latter. The Commission therefore rejects El Paso's proposal in this docket, without prejudice to

[1091] Pursuant to the pro forma service agreements in Part V of El Paso's FERC NGA Gas tariff, with the exception that Rate Schedule FT, IT, and PAL agreements executed prior to January 1, 2006 will be subject to the governing law provisions stated in such agreements.

El Paso making a new proposal in another docket addressing the concerns discussed above.

C. <u>Automatic Waiver of SOC/COC Penalties During *Force Majeure* (Stipulated Issue X.E)</u>

745. El Paso's tariff provides that El Paso may declare a Strained Operating Condition (SOC) or Critical Operating Condition (COC) if pipeline integrity is threatened or service to other shippers/operators may be affected and receipt/delivery variations from scheduled quantities cannot be accommodated.[1092] Any shipper that does not comply with an SOC/COC notice by conforming its receipts/deliveries to specified tolerances is assessed an SOC/COC daily imbalance penalty.[1093]

746. Indicated Shippers propose to modify the SOC/COC tariff provisions to prohibit SOC/COC penalties from being imposed during the first 24 hours of a *force majeure* event.[1094] Although Indicated Shippers do not question the need for SOC/COC penalties to protect system integrity, they submit assessing the penalties during the first 24 hours of a *force majeure* event is unjust and unreasonable because such events are by definition outside anyone's control. El Paso counters that Indicated Shippers' proposal for an automatic waiver is nonsensical and has been rejected by the Commission on two previous occasions.

<u>Initial Decision</u>

747. The Presiding Judge found that Indicated Shippers did not satisfy their threshold burden of proof on this issue.[1095] First, he found that any argument that assessing SOC/COC penalties during the first 24 hours of a *force majeure* event is unjust and unreasonable because such events are by definition outside anyone's control is misdirected. The penalties are not imposed on *force majeure* events; they are imposed on inappropriate shipper *responses* to such events.[1096] The Presiding Judge concluded that

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[1092] *See* Ex. EPG-218 at 6-7.

[1093] *Id.* at 8.

[1094] *See* Ex. IS-1 at 25. The tariff defines *force majeure* events as "unplanned or unanticipated events or circumstances that are not within the control of the party claiming suspension of its obligation and which such party could not have avoided through the exercise of reasonable diligence." *See* Ex. EPG-219.

[1095] ID, 139 FERC ¶ 63,020 at P 326.

[1096] *Id.* (citing Ex. EPG-219).

the circumstance that a *force majeure* event is beyond a shipper's control does not mean the shipper is powerless to respond to it in an appropriate manner. Moreover, the Presiding Judge stated that Indicated Shippers incorrectly imply the SOC/COC penalties are automatically imposed but they are not. The Presiding Judge found that the record confirms El Paso thoroughly evaluates shipper response in the first instance, and exercises discretion to excuse performance or waive the penalties in appropriate circumstances.[1097] There is no allegation or evidence El Paso has inappropriately exercised or failed to exercise that discretion. The Presiding Judge found that Indicated Shippers failed to prove the current *force majeure* SOC/COC penalty provisions or procedures are unjust or unreasonable.

Briefs on Exception

748. The Indicated Shippers contend that the Presiding Judge erred in failing to acknowledge (1) that a limited 24-hour waiver balances El Paso's need for shippers to react quickly with a shipper's ability to appropriately respond and realign its transportation and supply arrangements, and (2) that El Paso's competitors (including Transwestern Pipeline Company) grant waivers of critical condition penalties during the entirety of a *force majeure* event; therefore, this proposal should be approved as just and reasonable.[1098]

Briefs Opposing Exceptions

749. El Paso asserts that the Presiding Judge correctly found that Indicated Shippers had not justified their proposal for an automatic waiver of SOC/COC penalties during the first 24 hours of a *force majeure* event.[1099] In testimony and on brief to the Presiding Judge, El Paso notes, Indicated Shippers argued that during the first 24 hours of a *force majeure* event, a shipper, by definition, cannot stay in balance and avoid a penalty.[1100] El Paso concludes that, given the overwhelming evidence that shippers can take actions to stay in balance, Indicated Shippers appears to have abandoned this claim in its brief on exceptions. El Paso argues that Indicated Shippers failed to adduce any evidence

[1097] *Id.* (citing Ex. EPG-218 at 4).

[1098] Indicated Shippers Brief on Exceptions at 27-28 (citing Ex. IS-12 which refers to Transwestern's tariff provision granting waiver of critical condition penalties during the entirety of a force majeure event).

[1099] El Paso Brief Opposing Exceptions at 172.

[1100] *See, e.g.,* Indicated Shippers Initial Brief at 47 (it is unfair to charge a shipper a penalty "when the shipper can do nothing to avoid the penalty.").

showing the inability or difficulty in realigning transportation and supply arrangements to prevent harm to other shippers. El Paso explains that, to the contrary, there are several actions a shipper could take during a *force majeure* event to stay within imbalance tolerance levels and avoid a penalty, including reducing takes of gas to the levels scheduled and changing nominations in subsequent cycles during the gas day to reflect actual performance.[1101] In addition, El Paso notes that the Commission has previously rejected similar proposals.[1102] In sum, El Paso asserts, Indicated Shippers failed to satisfy their section 5 burden of demonstrating that the lack of an automatic penalty waiver in El Paso's tariff is unjust and unreasonable, that their proposal is just and reasonable, and/or that the Commission should depart from El Paso-specific precedent.[1103]

750. SoCal Gas/San Diego argue that the Presiding Judge's finding that Indicated Shippers have not satisfied their threshold burden under section 5 is amply supported by the record evidence.[1104] SoCal Gas/San Diego argue that Indicated Shippers have made no showing that all or even most *force majeure* events result in the affected party being unable to perform any of its obligations for a minimum of 24 hours after the event. SoCal Gas/San Diego argue that Indicated Shippers have not presented any evidence concerning the length of time that shippers on El Paso's system have been unable to perform any of their contractual obligations as a result of a *force majeure* event on the El Paso system. SoCal Gas/San Diego argue that Indicated Shippers concede that while the occurrence of the *force majeure* event itself is outside anyone's control, the response to the event is within the partial control of both El Paso and the affected shippers, who may have the ability to schedule supplies out of an alternate basin when a *force majeure* event occurs.[1105] SoCal Gas/San Diego argue that it appears that the purpose of Indicated Shippers' proposal is to secure a 24-hour option to avoid potential increased costs of scheduling supplies out of an alternate basin when supplies have been disrupted out of a basin affected by a *force majeure* event and an SOC/COC has been declared. SoCal Gas/San Diego agree with the Presiding Judge that Indicated Shippers' comparison with

[1101] El Paso Brief Opposing Exceptions at 173 (citing Ex. EPG-218 at 8, 16).

[1102] *Id.* (citing *March 23, 2006 Order,* 114 FERC ¶ 61,305 at P 279; *El Paso Natural Gas Co.,* 128 FERC ¶ 61,205, at P 12 n.7 (2009)).

[1103] *Id.* at 174.

[1104] SoCal Gas/San Diego Brief Opposing Exceptions at 58-60.

[1105] *Id.* at 60 (citing Tr. 1638:11-1639:7).

Transwestern was too vague, and El Paso may exercise its discretion to excuse performance or waiver penalties when necessary.[1106]

Commission Determination

751. The Commission affirms the Presiding Judge's finding that Indicated Shippers have failed to satisfy their section 5 burden of proof. Indicated Shippers have not shown that El Paso's SOC/COC daily imbalance penalty provisions are unjust and unreasonable.

752. El Paso's SOC/COC daily imbalance penalty provisions provide incentives to encourage shippers to perform actions (such as reducing or increasing gas deliveries to scheduled levels or arranging for alternate supply sources) to protect the system and other shippers when El Paso experiences strained or critical operating conditions. These penalties are not unavoidable, however. El Paso's tariff provides a variety of tools to help shippers minimize or avoid SOC/COC penalties, such as safe harbor thresholds, netting, catch-up nominations, and various firm and interruptible services. In addition, Section 18.1 of the General Terms and Conditions (GT&C) of El Paso's tariff provides El Paso with discretion to waive these penalties if a shipper requests such a waiver and El Paso determines that the shipper's actions justify a waiver and did not contribute to the harm of another shipper and/or the pipeline's operations.[1107]

753. Indicated Shippers argue that because penalties are designed to deter specific conduct, and *force majeure* events are not within a shipper's control, it is thus nonsensical to apply penalties in *force majeure* situations where deterrence is inapplicable. As the Presiding Judge correctly notes, however, the SOC/COC penalties are not imposed on *force majeure* events, but on shippers' responses to such events.[1108] As a result, deterrence is indeed applicable in *force majeure* situations to minimize harm to other shippers and system operations. There are a number of actions that a shipper can take to stay within imbalance tolerance levels and avoid a penalty. As the Presiding Judge found, El Paso evaluates shippers' actions in response to an SOC/COC and exercises discretion in excusing performance or waiving penalties. Moreover, the Presiding Judge found that there is no allegation or evidence that El Paso has inappropriately exercised its discretion. For these reasons, the Commission affirms the

[1106] *Id.* at 60-61.

[1107] Ex. EPG-218 at 9; Ex. EPG-221. El Paso notes that it also may ask the Commission to waive an SOC/COC daily balancing penalty, as it did in Docket No. RP11-2288-000. *See El Paso Natural Gas Co.*, 136 FERC ¶ 61,219 (2011).

[1108] ID, 139 FERC ¶ 63,020 at P 326.

Presiding Judge's finding that Indicated Shippers have failed to prove that the current *force majeure* SOC/COC penalty provisions or procedures are unjust or unreasonable.

XII. Compliance

754. Within 60 days of the date of this order, El Paso is required to file *pro forma* recalculated rates consistent with the terms of this order.[1109] El Paso is required to provide work papers in electronic format, including formulas, reflecting each of the adjustments required by this opinion to those that went into effect April 1, 2011. There should be three sets of *pro forma* recalculated rates and work papers: a) those related to findings effective April 1, 2011; b) those related to the abandonment of the Tucson and Deming Compressor Stations, effective September 15, 2011; and c) those related to Commission findings under NGA section 5 with a prospective effective date.[1110] If El Paso requests rehearing of this order, it is required to provide an additional separate set of recalculated rates identifying the rate impact of each item at issue, with supporting work papers in electronic format, including formulas.

755. Parties to this proceeding should file any comments they may have on El Paso's compliance filing within 30 days of the date of the filing.

756. The Commission will issue an order addressing El Paso's tariff and refund obligations at a later date.

<u>The Commission orders</u>:

(A) The findings on the issues addressed in the Initial Decision are affirmed and adopted, or reversed and/or remanded, as discussed in the body of this order.

(B) With respect to the issue whether El Paso has met the 4,000 MMcf/d presumption to indicate that the additional rate protections in Article 11.2(b) of the 1996 Settlement are not triggered, the Initial Decision is reversed and remanded for further proceedings to address whether, under El Paso's rate proposal as modified herein, shippers protected by Article 11.2(b) would be charged costs of unsubscribed or

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[1109] El Paso should make this filing utilizing eTariff Type of Filing Code (TOFC) 620 in Docket No. RP10-1398-000. Each Attachment Description and Attachment Document File Name should clearly identify the contents of the attachment. *See Implementation Guide for Electronic Filing of Parts 35, 154, 284, 300, and 341 Tariff Filings* (August 12, 2013) for the definitions of these data elements, *available at* http://www.ferc.gov/docs-filing/etariff/implementation-guide.pdf.

[1110] E.g., Wilcox Lateral depreciation; storage compression cost classification.

discounted capacity as defined in the settlement and if so develop an appropriate remedy. The Office of Administrative Law Judges is directed to hold additional proceedings consistent with the Commission's determination above.

(C) To the extent this order omits discussion of particular exceptions, they have been considered and are denied.

(D) Within 60 days of the issuance of this order, El Paso must file revised *pro forma* recalculated rates consistent with the terms of this order. El Paso is required to provide work papers in electronic format, including formulas, reflecting each of the adjustments required by this opinion. El Paso is also required to compare the revised rates to those required by Opinion No. 517. If El Paso files requests for rehearing, it is required to also provide recalculated rates identifying the rate impact of each item at issue, with supporting work papers in electronic format, including formulas.

(E) Parties to this proceeding should file any comments they may have on El Paso's compliance filing within 30 days of the date of the filing.

(F) Within 30 days of a final order in this case, El Paso must refund amounts recovered in excess of the just and reasonable rates approved by the Commission.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

Docket No. RP10-1398-000

Appendix A

List of Participants filing Briefs on and Opposing Exceptions

Briefs on Exceptions:
Arizona Public Service Co. (APS)
Commission Trial Staff (Trial Staff)
Competitive Power Suppliers: Gila River Power, L.P. (Gila River) and New Harquahala Generating Company, LLC. (New Harquahala) (Competitive Suppliers)
El Paso Electric Company (El Paso Electric)
El Paso Municipal Customer Group: Cites of Mesa, Benson, Safford and Willcox, Arizona; Cities of Las Cruces, Deming and Socorro, New Mexico; the Navajo Tribal Utility Authority; Graham County Utilities, Inc.; and Duncan Rural Service Corporation (Municipal Customers)
El Paso Natural Gas Company (El Paso)
Freeport-McMoRan Corp. (Freeport)
Hourly Service Shipper Group: Arizona Electric Power Cooperative, Inc. (Arizona Electric), El Paso Electric, Gila River, New Harquahala, Salt River Project Agricultural Improvement and Power District (Salt River), Sempra Global and Texas Gas Service Co. (Sempra)
Indicated Shippers: BP America Production Co., BP Energy Co., ConocoPhillips Company (ConocoPhillips), and Shell Energy North America (US), L.P.
Joint Parties on shortfall issue: Arizona Corporation Commission (ACC); Arizona Electric; Gila River; Golden Spread Electric Cooperative, Inc. (Golden Spread); New Harquahala; Salt River; Sempra; and Southwestern Public Service Co. (Southwestern)
New Mexico Gas Co., Inc. (New Mexico Gas)
Rate Protected Shippers and ACC: ConocoPhillips, Municipal Customers, Freeport, New Mexico Gas, Southwest Gas Corporation (Southwest Gas), and UNS Gas, Inc. (UNS)
Salt River
Sempra
Southern California Gas Company and San Diego Gas & Electric Co (SoCal Gas/San Diego)
Southern California Edison Co. (Edison)
Southwestern
Texas Gas Service Company, a division of ONEOK, Inc. (Texas Gas Service)
UNS and Tucson Electric Power Company (UNS/Tucson Electric)

Briefs Opposing Exceptions:
ACC and Southwest Gas
APS

California Public Utilities Commission (CPUC)
Competitive Suppliers
ConocoPhillips
El Paso
El Paso Electric
Freeport, Apache Nitrogen Products, Inc., and Municipal Customers
Hourly Service Shipper Group
Indicated Shippers
New Mexico Gas
Rate Protected Shippers/ACC
Salt River
Edison
SoCal Gas/San Diego
Texas Gas Service
Trial Staff
UNS/Tucson Electric