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

El Paso Natural Gas Company

Docket Nos. RP10-1398-003
RP10-1398-000
RP10-1398-004

OPINION NO. 528-A

ORDER ON INITIAL DECISION, REHEARING AND COMPLIANCE

Issued: February 18, 2016

Table of Contents

Paragraph Numbers

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Before Commissioners: Norman C. Bay, Chairman;
Cheryl A. LaFleur, Tony Clark,
and Colette D. Honorable.

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ORDER ON INITIAL DECISION, REHEARING AND COMPLIANCE

(Issued February 18, 2016)

1. In this order, the Commission acts on requests for rehearing, an Initial Decision on remand and the Compliance Filing all made in response to Opinion No. 528, the October 17, 2013 Opinion and Order on Initial Decision in Docket No. RP10-1398-000.[1] In this Opinion 528-A, the Commission reviews and with one exception denies the requests for rehearing and clarification filed by El Paso Natural Gas Company, L.L.C. (El Paso) and a number of other Parties[2] in response to Opinion No. 528. The Commission grants rehearing with respect to its decision that El Paso should follow the Commission's policy favoring allocation of costs based on unadjusted billing determinants, with the result that discount adjustment costs would be allocated within the zone in which the discount was granted. The rate data provided in the Compliance Filing shows unreasonable rate disparities when the policy is applied to the existing El Paso zonal rate structure.

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[1] *El Paso Natural Gas Co.*, Opinion No. 528, 145 FERC ¶ 61,040 (2013), *addressing*, Initial Decision, 139 FERC ¶ 63,020 (2012) (ID or Initial Decision). El Paso's December, 16, 2013 Compliance Filing was submitted in Docket No. RP10-1398-000.

[2] Opinion No. 528, Appendix A provides the designations identifying the Parties in this proceeding.

2. In addition, the Commission adopts the Presiding Judge's determination in the Initial Decision issued on September 17, 2014 finding the methodology proposed by Trial Staff to be a just and reasonable remedy to ensure that El Paso's rates are consistent with Article 11.2(b) of the 1996 Settlement, and addresses the arguments raised in the briefs on and opposing exceptions on the remanded issue that were filed in Docket No. RP10-1398-003.[3] In keeping with these actions, the Commission accepts El Paso's revised tariff records as consistent with the Commission's directives in Opinion No. 528, subject to revision to incorporate the determinations made in this Opinion No. 528-A.

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 near the California border at 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," delivering natural gas between the North and South Systems.

4. The issues addressed in this proceeding relate to events on El Paso's system dating back over twenty years. The last fully litigated El Paso rate proceeding was in 1959. Since that time, El Paso has filed several Natural Gas Act (NGA) general section 4 rate cases, which resulted in settlements, including the 1996 Settlement, the 2006 Rate Case Settlement, and the 2008 Rate Case Settlement.[4]

5. The 1996 Settlement, among other things, established a rate cap for certain shippers, in exchange for up front risk sharing payments, and also entitled settling customers to a portion of remarketing revenues for the term of the settlement. Specifically, Article 11.2(a) of the 1996 Settlement provided that rates for capacity then

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[3] *El Paso Natural Gas Co.*, Initial Decision, 148 FERC ¶ 63,014 (2014) (Remand Decision). This Remand Decision reviewed proposals to address Article 11.2(b) of the 1996 Settlement, which restricts El Paso from charging settling customers costs of undersubscribed 1995 capacity; *see* filing of conforming changes to stipulation and agreement, Docket No. RP95-363-008 (June 9, 1997) (1996 Settlement), accepted in *El Paso Natural Gas Co*., 79 FERC ¶ 61,028, *reh'g denied,* 80 FERC ¶ 61,084 (1997).

[4] *See* Opinion No. 528, 145 FERC ¶ 61,040 at PP 5-19 for a summary of these major events. *See also* Remand Decision, 148 FERC ¶ 63,014 at PP 1-12.

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 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.

6. In the March 20 Order, the Commission established a presumption that the Article 11.2(b) requirement would not be triggered if El Paso had subscribed service of at least 4,000 MMcf/d (representing capacity El Paso had under subscription in 1995) priced at the Article 11.2(a) rate or above.[6] 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."[7]

7. In Opinion No. 517, the Commission clarified that the presumption threshold was established to "simplify compliance" and that it is "not the only method for determining compliance with Article 11.2(b)."[8] 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

[5] *See* 1996 Settlement, Article 11.2, sections (a) and (b), quoted in the discussion section, below.

[6] *El Paso Natural Gas Co.*, Order on Post [1996] Settlement Issues, 114 FERC ¶ 61,290, at P 60 (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 sub nom. Freeport-McMoRan Corp. v. FERC*, 669 F.3d 302 (D.C. Cir. 2012) (*Freeport*).

[7] September 5 Order, 124 FERC ¶ 61,227 at P 98.

[8] *El Paso Natural Gas Co.*, Opinion No. 517, 139 FERC ¶ 61,095, at P 323 (2012) (addressing four issues reserved for hearing by settlement on 2008 rate case filing), *order on reh'g*, Opinion No. 517-A, 152 FERC ¶ 61,039 (2015).

> whether El Paso proposes to shift the costs of unsubscribed or discounted capacity to the rates of Article 11.2(b) shippers.[9]

8. Consequently, "if the presumption is not met, other evidence might show that Article 11.2(b) is otherwise satisfied."[10] The Commission found in Opinion No. 517 that in addition to firm maximum rate contracts, it is appropriate 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 presumption had been met.[11] The Commission further found that the maximum rate equivalent of discounted contracts cannot be counted toward the presumption.[12]

A. Current Proceeding (2011 Rate Case)

9. This proceeding began on September 30, 2010 when El Paso filed a general rate case pursuant to NGA section 4 to propose a rate increase for existing services and changes to certain terms and conditions of service (2011 Rate Case). In the ensuing suspension order, the Commission (a) accepted El Paso's proposed primary tariff records subject to refund, hearing, and the outcome of the 2006 Rate Case, 2008 Rate Case, and Fuel Complaint Case proceedings; (b) rejected the alternate tariff records; and (c) suspended the effectiveness of the proposed rate increase and other tariff records until April 1, 2011.[13]

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[9] Opinion No. 517, 139 FERC ¶ 61,095 at P 322.

[10] *Id.* P 323.

[11] *Id.* PP 325-328.

[12] *Id.* P 329. A maximum rate equivalent is an approximation of the volume of maximum rate contracts which might stand in for a discount-rate contract in an attempt to estimate how discounted contracts could be counted toward the 4,000 MMcf/d threshold, in a manner comparable to maximum rate contracts. The use of maximum rate equivalents to approximate purported discount rate contributions to the threshold was rejected in Opinion No. 517, 139 FERC ¶ 61,095 at P 329.

[13] *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). See the background summary in Opinion No. 528.

10. 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."[14] 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."[15] 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]."[16] The Commission also held that the issue of the duration of Article 11.2 contracts is not an issue in the 2011 Rate Case.[17]

11. The hearing was conducted from October 25, 2011 through December 14, 2011. The Presiding Judge issued an Initial Decision addressing the 2011 Rate Case on June 18, 2012.[18]

12. On October 17, 2013, the Commission issued Opinion No. 528, an Opinion and Order on Initial Decision, affirming in part and modifying in part the Initial Decision and setting for a supplemental hearing the appropriate remedy for El Paso's failure to meet the requirements of Article 11.2(b) of the 1996 Settlement. In Opinion No. 528, the Commission made a number of other determinations. The Commission reviewed evidence and exceptions relating to El Paso's return on equity (ROE) and affirmed the Presiding Judge's proxy group selection and rejection of El Paso's proposal to change the Commission's discounted cash flow (DCF) methodology. In addition, the Commission reversed the finding that El Paso should be placed well above the median return on equity and found 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. The Commission found that El Paso must exclude costs related to the abandoned Tucson and Deming Compressor Stations from its cost of service and approved rates for premium flexible services, generally affirming the depreciation determinations in the Initial

[14] 2011 Rate Case Suspension Rehearing, 133 FERC ¶ 61,253 at P 16.

[15] *Id*.

[16] *Id*. P 14.

[17] *Id*. P 12.

[18] Initial Decision, 139 FERC ¶ 63,020.

Decision, but reversing the ruling to use contract length to establish useful life for the Willcox lateral facility.[19]

13. With respect to Cost Allocation and Rate Design, the Commission affirmed El Paso's zone of delivery/contract path methodology, with the modification to reject use of adjusted billing determinations, and rejected the alternatives, including El Paso's proposals to equalize rates in California and bordering states and new "within basin" production zone rate methodology. In addition, the Commission rejected shippers' proposed postage-stamp rate proposal and automatic daily balancing provisions. The Commission affirmed El Paso's discount adjustment, and rejected cost-sharing for unsubscribed capacity. The Commission reviewed the latest exceptions relating to the continued effectiveness and applicability of El Paso's 1996 Settlement and affirmed that Article 11.2 remains in effect, consistent with the public interest, and upheld the Article 11.2 rate caps. As to implementing the terms of the 1996 Settlement, the Commission affirmed that El Paso may not reallocate shortfalls to non-settlement recourse customers, and rejected El Paso's proposed bifurcated cost of service as unsupported and not just and reasonable. The Commission reversed the Presiding Judge's finding that El Paso met the 4,000 MMcf/d threshold to demonstrate that Article 11.2(b) rate protections were not triggered. The Commission rejected the Judge's reliance on an earlier finding because the determination in Opinion No. 517 reflected facts at the time of that proceeding. When the Commission applied the approach in Opinion No. 517 to more current contract data, it found that El Paso has not met the threshold and remanded the issue for determination of the appropriate remedy.[20]

14. Because El Paso failed to satisfy the requirements of Article 11.2(b) of the 1996 Settlement, the Commission found that it was necessary to determine an appropriate means to ensure compliance with that article. Lacking a sufficient record, the Commission remanded the remedy 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).

15. To comply with its determinations, the Commission directed El Paso to file *pro forma* recalculated rates, consistent with Opinion No. 528, within 60 days. The Commission stated that the compliance filing should use the approved rate design, a

[19] Opinion No. 528, 145 FERC ¶ 61,040.

[20] *Id.* P 520.

single cost of service instead of El Paso's bifurcated cost of service and a single billing determinant data set for the 12-month period ending March 31, 2011.

B. Filings Made Following Opinion No. 528

16. On November 18, 2013, requests for rehearing and/or clarification were filed by El Paso; Arizona Corporation Commission and Southwest Gas Corporation (ACC/Southwest Gas); the California Public Utilities Commission (CPUC); El Paso Electric Company (El Paso Electric); Hourly Services Shipper Group;[21] Indicated Shippers;[22] Sempra Global and Golden Spread Electric Cooperative, Inc. (Sempra/Golden Spread); Southern California Edison Company (Edison); Southern California Gas Company and San Diego Gas & Electric Company (SoCal Gas/San Diego); and UNS Gas, Inc. and Tucson Electric Power Company (UNS/Tucson Electric). ConocoPhillips Company (ConocoPhillips)[23] and Texas Gas Service Company, a Division of ONEOK, Inc. (Texas Gas Service)[24] originally requested rehearing, but withdrew their pleadings by agreement with El Paso.

17. El Paso's December 16, 2013 Compliance Filing was submitted providing *pro forma* rates and work papers to reflect the Commission's findings as of the following effective dates: (a) April 1, 2011; (b) effective September 15, 2011, to reflect the abandonment of the Tucson and Deming Compressor Stations; and (c) prospectively, to reflect findings under NGA section 5. El Paso also included recalculated rates and

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[21] For purpose of rehearing, the Hourly Services Shipper Group includes Arizona Electric Power Cooperative, Inc. and Sempra. Texas Gas Service withdrew its participation in this request for rehearing by agreement with El Paso. *See* Texas Gas Service, August 4, 2014 notice of withdrawal, and July 1, 2014 settlement in Docket No. RP14-1088-000.

[22] The Indicated Shippers include BP Energy Company and Shell Energy North America (US), L.P.; ConocoPhillips withdrew from participation in the Indicated Shippers by agreement with El Paso.

[23] ConocoPhillips' April 15, 2015 notice of withdrawal reflected the termination of its participation in the proceeding, as well as the withdrawal of its rehearing and answer and participation through the Indicated Shippers' pleadings. *See also* the February 27, 2015 Letter Agreement in Docket No. RP15-583-000.

[24] *See* Texas Gas Service, August 4, 2014 Notice of Withdrawal and July 1, 2014 Settlement in Docket No. RP14-1088-000.

workpapers to reflect the rate impact of each of the issues El Paso raised on rehearing for each of these time periods.

18. The hearing on the remanded issue was conducted from June 4, 2014 through June 5, 2014. The hearing addressed the issues identified by the parties in the May 16, 2014 Preliminary Joint Narrative Statement of Issues: (a) Whether, under El Paso's rate proposal as modified in Opinion No. 528, shippers protected by Article 11.2(b) would be charged costs of unsubscribed or discounted capacity as defined in the 1996 Settlement and (b) If so, what is an appropriate remedy. The Presiding Judge issued the Remand Decision on September 17, 2014.[25]

II. Rehearing Issues – Docket No. RP10-1398-004

19. The Commission addresses the issues raised on rehearing and generally affirms its holdings in the prior order, as discussed below. However, in light of the updated rate information provided in El Paso's Compliance Filing and as discussed more fully below, the Commission grants rehearing and reverses its decision to require El Paso to use unadjusted billing determinants to allocate costs among zones. In addition, the Commission summarily rejects rehearing on the treatment of debt costs. El Paso requests rehearing of the Commission's application of its determination from Opinion No. 517, that a loan to El Paso's parent corporation should be deducted from its equity capitalization.[26] In Opinion No. 528, the Commission verified the outstanding loan amount, which was deducted from the equity ratio, and otherwise adopted the position in Opinion No. 517 subject to rehearing.[27] We affirm the decision in Opinion No. 528 to apply the Opinion No. 517 approach to the outstanding dollar amounts derived at hearing subject to the outcome of the proceeding in Docket No. RP08-426-000 on the controlling issue of whether the loan and undistributed subsidiary earnings should be removed from the pipeline's capital structure.

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[25] Remand Decision, 148 FERC ¶ 63,014.

[26] 139 FERC ¶ 61,095 at P 86.

[27] Opinion No. 528, 145 FERC ¶ 61,040 at P 590.

A. **Depreciation and Negative Salvage**

1. **Mainline and Storage Depreciation Rates**

Opinion No. 528

20. El Paso proposed a variable range of depreciation rates that would rely upon the Commission's determination of other cost-of-service factors. El Paso proposed that its existing rates of 2.20 percent for transmission plant and 1.09 percent for underground storage plant serve as the lowest possible (floor) rates in the variable scale. At the top end of the scale, El Paso proposed ceiling rates of 3.07 percent for transmission plant and 2.42 percent for underground storage plant. Under the proposal, El Paso would implement the higher depreciation rates to offset any rate reduction if the Commission changed other cost-of-service factors. Trial Staff promoted an alternate depreciation study, showing slightly higher rates, but supported El Paso's currently-effective depreciation rates as just and reasonable because they are consistent with the three primary factors used to determine depreciation rates (exclusive of negative net salvage): the pipeline's remaining economic life, interim retirements and net plant.

21. In Opinion No. 528, the Commission affirmed the Presiding Judge's rejection of El Paso's variable range proposal for depreciation rates. The Commission agreed with the Presiding Judge's finding that the proposal lacked precedent, and further noted that the arguments for the proposal were equivocal, vague, and poorly supported.[28] The Commission affirmed the Presiding Judge's determination that only El Paso's existing mainline transportation and storage depreciation rates were addressed and given adequate support during the proceeding.

Request for Rehearing

22. El Paso does not challenge the rejection of the variable depreciation proposal, but argues that the Commission erred by failing to accept the higher depreciation rates calculated by Trial Staff, which exceeded the currently effective transportation rate (2.20 percent) and storage rate (1.09 percent). El Paso claims that Trial Staff's study justified 2.22 percent for the transportation function and 1.60 percent for storage. El Paso cites its Brief on Exceptions arguing that Trial Staff's rates should be accepted if its variable range proposal was rejected.[29]

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[28] *Id.* P 97.

[29] El Paso Rehearing at 101-102.

23. El Paso contests the Commission finding that El Paso failed to support higher depreciation rates. El Paso cites the depreciation study and testimony of its witness Mr. Feinstein supporting rates as high as 3.07 and 2.42 percent for transmission and storage. El Paso asserts that the Commission did not address or challenge the study performed by Mr. Feinstein that supports these rates, but only rejected these rates because it was a part of El Paso's variable range proposal. El Paso claims that the Commission failed to address the underlying elements of Mr. Feinstein's study, such as supply life, that support rates higher than El Paso's existing rates.[30]

Commission Determination

24. The Commission denies El Paso's request for rehearing. In its request, El Paso fails to recognize the Commission's affirmation of the Presiding Judge's core finding that the only rates proposed and properly supported were El Paso's existing depreciation rates. This finding was based on the conclusion of El Paso's witness that the company's existing rates are not excessive based on his study and its results.[31]

25. The Commission affirms its finding that El Paso's case for new depreciation rates was poorly defined and seriously hampered by the confusion injected into the proceeding by El Paso's proposed variable scale of depreciation rates. Despite accepting the Commission's finding against its variable scale of depreciation rates, El Paso argues that the Commission must still rule on each of the depreciation rates that were offered in its proposal and also on rates produced by Trial Staff's study. This argument in El Paso's rehearing request does not recognize the record in this case. The Commission agrees with the Presiding Judge's finding, based on the record in the case, that El Paso only proposed and adequately supported its current rates given the testimony of El Paso witnesses. The Commission's adoption of the existing rates obviates the need to address Trial Staff's findings.

[30] *Id.* at 102.

[31] Initial Decision, 139 FERC ¶ 63,020 at P 102 (citing Ex. EPG-130 at 4; "El Paso witness Feinstein states, 'I understand that in this case, [El Paso] is using my analysis to confirm that its existing rates… are not excessive. Based on my study and its results, I conclude that [El Paso's] existing rates are not excessive.'").

2. **Willcox Lateral Depreciation**

Opinion No. 528

26. Trial Staff proposed lowering the depreciation rate for El Paso's Willcox Lateral, a delivery lateral that transports natural gas from El Paso's southern mainline to the international border between Mexico and the United States, to match the depreciation rate for El Paso's mainline facilities. The Willcox Lateral was certificated in a 2000 certificate proceeding, at which time the Commission approved a 4.00 percent initial depreciation rate.[32] El Paso later filed to retain the 4.00 percent depreciation rate in a rate case proceeding in 2006. The proposed rate was subsequently reduced to 3.40 percent by a settlement of the 2006 Rate Case proceeding and maintained at this level in the 2008 Rate Case.[33]

27. The Presiding Judge found that Trial Staff failed to meet its section 5 burden to show that the current 3.40 percent depreciation rate was unjust and unreasonable and that its proposed rate was just and reasonable.[34] In Opinion No. 528, the Commission overturned the Presiding Judge, finding that Trial Staff adequately met its NGA section 5 burden and ordered that the depreciation rate for the Willcox Lateral be set at the 2.20 percent depreciation rate for El Paso's mainline facilities. In reversing the Initial Decision, the Commission explained that the Willcox Lateral does not qualify as an exception to the Commission's general policy that contract term (or contract life) should not be used to establish depreciation rates.[35]

Request for Rehearing

28. In its Rehearing, El Paso argues that the Commission erred in several respects in reversing the finding of the Presiding Judge. First, according to El Paso, the Commission failed to acknowledge that in the case of delivery laterals such as the Willcox Lateral, the economic life of the facility is measured by the term of the contract, not by the amount of supplies that could be projected to be delivered through a facility such as the mainline.

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

[33] 2006 Rate Case Settlement, filed Dec. 6, 2006 in Docket No. RP05-422-000, Art. 3.2, App. C. The 3.40 percent rate was retained in the 2008 Rate Case Settlement, Docket No. RP08-426-000, Art. 3.2, App. G (filed Mar. 11, 2010).

[34] Initial Decision, 139 FERC ¶ 63,020 at P 106.

[35] Opinion No. 528, 145 FERC ¶ 61,040 at P 112.

El Paso argues that contract life and economic life are not two different methods, and that, in the case of a delivery lateral whose life is limited by the demand at the end of the line, rather than by the supply that could be expected to be delivered into the pipeline, the term of the contract is the proper measure of the lateral's economic life.[36]

29. Second, El Paso argues that the Commission inappropriately found that depreciation rates should only be based on contracts in the event that provisions in the contracts expressly require customers to pay such depreciation rates. El Paso asserts that it should not matter whether the parties' expectations were based on an express contractual provision, or just the approval of a depreciation rate based on the life of the contracts.[37] According to El Paso, customers supporting the Willcox Lateral implicitly, if not explicitly, agreed to pay for the facilities over the life of their respective contracts.

Commission Determination

30. The Commission denies rehearing. Despite El Paso's arguments to the contrary, the Commission's long-standing policy is to not allow depreciation rates based on length of contract, including depreciation rates for laterals.[38] Although the Commission has approved exceptions to this rule, the Commission upholds its finding that Trial Staff adequately demonstrated that the Willcox Lateral does not qualify for an exception in this rate case. Exceptions to the Commission's 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.[39] In the case of the Willcox Lateral, such an obligation does not exist given an expansion of the facilities, renewed contracts and additional new contracts since the lateral's original construction. Simply stated, El Paso's Willcox Lateral shippers (including both original and new shippers) are not contractually obligated to pay the full cost of the facilities during the term of their contracts. El Paso argues that the Commission's insistence on the specific contractual obligations is misplaced and that a shipper implies its commitment to paying for the facilities by agreeing to a contractual rate (developed based in part on an underlying depreciation rate). However, the Commission does not agree that the shipper is making such an implied commitment,

[36] El Paso Rehearing at 104.

[37] *Id.*

[38] *See* Opinion No. 528, 145 FERC ¶ 61,040 at P 112 (citing *Northwest Pipeline Corp.*, 87 FERC ¶ 61,266 at 62,043 (1999) (*Northwest Pipeline*); *Kern River Gas Transmission Co.*, Opinion No. 486, 117 FERC ¶ 61,077 at PP 487-488 (2006)).

[39] Opinion No. 486, 117 FERC ¶ 61,077 at P 488.

given that contracts for service on the Willcox Lateral have been renewed, extended, or replaced.

31. El Paso argues that the contract life is the economic life of a facility in the case of a delivery lateral. Although this can be true in some circumstances, the Commission does not agree that it is universally true. In fact, the useful life of the facility can extend far beyond contract terms if a delivery lateral is built in an area of growing demand. This is exactly what Trial Staff demonstrates in its case for establishing depreciation rates for the Willcox Lateral. Trial Staff witness Pewterbaugh found the demand for the Willcox Lateral supply is contingent on the demand for natural gas in Mexico (primarily for electric generation). Referencing statistics from the U.S. Energy Information Administration, he stated that Mexican natural gas consumption is projected to grow at an average of 3.2 percent per year through 2035, more than double from 2.4 trillion cubic feet (Tcf) to 5.5 Tcf.[40]

32. El Paso provides an oversimplified version of Trial Staff's case for new depreciation rates for the Willcox Lateral. Contrary to El Paso's contention that Trial Staff's support for its proposal was merely that the mainline rates are "reasonable," the Commission finds that Trial Staff fully supported its position that the existing 3.40 percent depreciation rate for the Willcox Lateral is unjust and unreasonable and that applying the mainline depreciation rate of 2.20 percent to the Willcox Lateral is just and reasonable. As the Commission previously noted, 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 and that, from an economic standpoint, the same natural gas that supplies El Paso's mainline also supplies the Willcox Lateral. As stated previously, Trial Staff also adequately demonstrated that demand is expected to grow further over the next 20 years. The fact that there have been new and renewed contracts also indicates that there is ample demand for natural gas on El Paso's system.

3. Negative Salvage Rate

Opinion No. 528

33. El Paso initially proposed increasing its negative salvage rate to 0.18 percent from the current rate of 0.12 percent, citing increased retirement costs and lower salvage values as a result of environmental and safety regulations. El Paso attempted to demonstrate the economic trends necessitating the increase with an interim retirement analysis for 2009 and the last five years of plant retirement costs and salvage recoveries

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[40] Ex. S-24 at 21 (citing U.S. Energy Information Administration's *International Energy Outlook 2010*).

for the company (2005-2009). In rebuttal testimony, El Paso updated its case by presenting data for a sixth year, which the company argued supported a negative salvage rate of 0.23 percent. El Paso proposed an increase in the rate to 0.23 percent depending on the Commission's decisions on other elements of its cost of service. Trial Staff argued that El Paso impermissibly proposed a range of salvage rates and changed its proposal inappropriately late in the proceeding. Trial Staff asserted that El Paso also failed to justify a higher negative salvage rate because the scope of El Paso's analyses only encompassed five or six years of data.

34. In Opinion No. 528, the Commission affirmed the ruling of the Presiding Judge in rejecting proposed increases to El Paso's current negative salvage rate of 0.12 percent. The Commission agreed with the Presiding Judge's finding that El Paso had not shown that the recent trend of higher retirement costs and lower salvage values experienced during the last five to six years (which El Paso argued supported a negative salvage rate of 0.18 percent) was likely to continue over the longer term. The Commission also rejected El Paso's variable range proposal which, similar to the company's depreciation rate proposal, allowed for different rates depending on Commission action on other parts of El Paso's proposed rates.

Request for Rehearing

35. El Paso argues that the evidence of the record supports the negative salvage rates of 0.18 percent proposed in its direct testimony and 0.23 percent following the introduction into evidence of updated test period plant retirement costs. While clarifying that it does not challenge the Commission's rejection of its variable negative salvage rate, El Paso states that this rejection is not a valid basis to ignore the updated test period plant retirement costs.[41]

36. El Paso argues that the increase in the negative net salvage rate results from a trend of increasing costs to remove retired assets and declining amounts recovered from the salvage of those retired assets. This trend, according to El Paso, was shown by the retirement costs, net of salvage, experienced in the five-year period from 2005 to 2009, as well as in the updated actual test period plant retirement costs, and the updated trend of retirement costs and salvage values to cover a sixth year. El Paso asserts that the Commission's holding that El Paso failed to show this trend was likely to continue cannot be squared with this evidence.[42]

[41] El Paso Rehearing at 111.

[42] *Id*. at 110.

37. According to El Paso, it offered substantial evidence supporting the trend of increasing costs required to decommission and remove pipeline facilities in a safe and environmentally acceptable manner. El Paso states its evidence showed labor rates, population encroachment, environmental concerns, and increasingly stringent pipeline safety requirements contributing to increasing decommissioning costs. El Paso states that to use a greater period of time, such as 20 or 30 years, could mask these recent trends and result in an unrepresentative level of cost projections.

Commission Determination

38. The Commission denies rehearing of its decision on El Paso's negative net salvage rate. In its request, El Paso repeats its primary contention in the litigated proceeding that its study of plant retirement costs suffices to show the need for the increase in the salvage rate. However, the Commission reiterates its affirmation of the Presiding Judge's finding that El Paso failed to show why El Paso's five-year period is an appropriate sample for long-term salvage rate analysis. As the Presiding Judge stated, El Paso did not "specify any comparison period(s). Nor does it illustrate any comparison(s)."[43]

39. El Paso failed to provide data that supported a trend over an extended period, which is critical to carrying out the long-term economic analysis required to derive depreciation and salvage rates for long-lived facilities such as pipelines. As pointed out by Trial Staff, the Commission has never approved a negative salvage rate for a pipeline based on only five years of data.[44] In its rehearing request, El Paso again cites the cautionary note in the NARUC Manual *Public Utility Depreciation Practices*, where the authors state a study of retirement costs over a long period of time could "mask any trend."[45] However, the Commission notes that the same passage continues: "However, with certain long-lived property, such as conduit and buildings, in order to obtain meaningful results, it is usually necessary to examine data for a wide band of years, perhaps 20 or 30 years."[46] El Paso's pipeline facilities qualify as such long-lived property. The Commission upholds its finding in Opinion No. 528 that El Paso failed to demonstrate its proposed rates for negative salvage were just and reasonable.

[43] Initial Decision, 139 FERC ¶ 63,020 at P 116.

[44] Trial Staff Brief on Exceptions at 117.

[45] El Paso Rehearing at 110 (citing Ex. S-53 at 36).

[46] *Id.*

B. Rate Base (Tucson/Deming Compressor Station Abandonment)

40. In Opinion No. 528, the Commission affirmed the Presiding Judge's ruling to exclude from El Paso's cost of service the costs related to the abandoned Tucson and Deming Compressor Stations. El Paso filed to abandon the Compressor Stations on September 28, 2010, two days before filing the 2011 Rate Case application, but the Commission order authorizing the abandonment was not issued until September 11, 2011, after the end of the test period.[47] In the Opinion, the Commission referenced *National Fuel* which stated:

> 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.[48]

41. In Opinion No. 528, the Commission noted that El Paso's Abandonment Application[49] included many statements reflecting El Paso's intent to abandon the Compressor Stations because they were obsolete and served no function in the transportation of natural gas.[50] The Commission also pointed out that El Paso repeatedly stated that the abandonment would not affect service to current or anticipated customers,[51] that the facilities had been operated and maintained only as necessary to meet regulatory requirements,[52] that they created unnecessary costs for ratepayers,[53] and

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

[48] Opinion No. 528, 145 FERC ¶ 61,040 at P 184 (citing *National Fuel Gas Supply Corp*., 51 FERC ¶ 61,122, at 61,334 (1990) (*National Fuel*) (footnotes omitted)).

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

[50] Opinion No. 528, 145 FERC ¶ 61,040 at P 185 (citing Abandonment Application at 1, 4, 5, 6, 7, 12).

[51] *Id*. (citing Abandonment Application at 6, 7, 8, 9, 10, 13).

[52] *Id*. (citing Abandonment Application at 6, 7).

that the cost reduction should be reflected in future rates.[54] The Commission stated that, while El Paso correctly pointed out that the Abandonment Order and actual abandonment of the facilities occurred after the close of the test period, El Paso did not dispute that the Compressor Stations have not served any real function related to the transportation of natural gas for a number of years and were only operated to meet regulatory requirements.[55]

42. The Commission found that the cases cited by El Paso to justify including the abandoned facility costs in its rates are distinguishable from the instant case and do not require a different result. For instance, 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.[56] In *Northwest*, the pipeline did not enter into a contract for the sale of the facilities until after it filed its rate case.[57] In contrast, Opinion No. 528 found that El Paso anticipated the abandonment and related cost savings of the Compressor Stations when it filed its Abandonment Application in advance of the rate case filing. In another case cited by El Paso – Opinion No. 395 -- the Commission found no evidence the compressors were not used during the earlier part of the test period,[58] which differs from the instant case where it is clear that the Tucson and Deming Compressor Stations were not used for natural gas transportation for a number of years prior to the Abandonment Application. Finally, the other cases cited by El Paso were certificate proceedings that involved proposed new construction to improve the pipelines' service and reliability,[59] and are distinguishable from the facts in the instant case in which El Paso seeks to include the costs of the facilities that it has abandoned.[60]

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[53] *Id*. (citing Abandonment Application at 7, 12, 13).

[54] *Id*. (citing Abandonment Application at 4 n.5, 12).

[55] Opinion No. 528, 145 FERC ¶ 61,040 at P 186.

[56] *Id*. P 187 (citing *Panhandle Eastern Pipe Line Co.*, Opinion No. 404, 74 FERC ¶ 61,109, at 61,354 (1996) (*Panhandle I*)).

[57] *Id*. (citing *Northwest Pipeline*, 87 FERC ¶ 61,266 at 62,051-62,055).

[58] *Id*. P 188 (citing *Panhandle Eastern Pipe Line Co*., Opinion No. 395, 71 FERC ¶ 61,228, at 61,824-61,825 (1995) (*Panhandle II*)).

[59] *Id*. P 189 (citing *Great Lakes Gas Transmission Limited Partnership*, 74 FERC ¶ 61,171, at 61,596-61,597 (1996); *Wyoming Interstate Co., Ltd*., 76 FERC ¶ 61,252, at

(continued...)

43. The Commission found that including the costs of the abandoned facilities in its rates would be unjust and unreasonable. The Commission however modified the Initial Decision to make the Commission's ruling on this issue effective as of the date of the *Abandonment Order*, September 15, 2011.[61]

Request for Rehearing

44. El Paso argues the Commission's ruling, that El Paso must remove costs and related expenses associated with the Tucson and Deming Compressor Stations that were abandoned after the test period, violates the principle that the pipeline's rates should be based on the pipeline's costs incurred during the test period.[62]

45. El Paso claims that the Commission rejected a number of El Paso's proposed adjustments to test period costs or volumes in favor of actual test period costs or volumes.[63] For example, the Commission rejected El Paso's proposed normalization of its compression station overhaul expense based on the cold snaps that delayed some overhauls during the test period because the Commission found that El Paso had not shown the actual test period expenses were substantially in error. The Commission also rejected the normalization of periodic maintenance expenses because it was an "impermissible deviation from the established test period because it is based on projected, not incurred costs."[64]

46. El Paso argues that the Commission only supports reaching beyond the test period if the changes are substantial in nature and would correct estimates that were substantially in error. El Paso asserts that the Commission did not support its finding that this standard was met with regard to the Tucson and Deming Compressor Station costs. El Paso contends that if the Commission can exclude the costs of the facilities that were

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62,308-62,309 (1996) (*Wyoming Interstate*); *Eastern Shore Natural Gas Co.*, 76 FERC ¶ 61,358, at 62,677, 62,680 (1996) (*Eastern Shore*)).

[60] Opinion No. 528, 145 FERC ¶ 61,040 at PP 187-189.

[61] *Id*. P 190.

[62] El Paso Rehearing at 92.

[63] *Id*. at 93 (citing Opinion No. 528, 145 FERC ¶ 61,040 at PP 45, 62-63, 208 and 210).

[64] *Id*.

not abandoned until after the test period then theoretically El Paso should be able to include the cost of other facilities or billing determinant reductions that occurred also after the test period.[65]

47. El Paso notes that the Commission failed to address or acknowledge the precedent in *Tennessee*.[66] El Paso argues that in *Tennessee*, an abandonment was anticipated to occur prior to the end of a test period, but when it did not occur until several months after the end of the test period, the Commission ruled that the regulations do not require the cost of service changes resulting from this abandonment to be reflected in Tennessee's pending rate proceeding.[67]

48. El Paso argues that the Commission erroneously distinguished *Panhandle* from the instant issue.[68] The Commission stated that in *Panhandle,* the pipeline had used the compressors for part of the test period but that in the instant case the El Paso facilities were not "used for natural gas transportation service" for a number of years prior to El Paso's application to abandon them. El Paso disagrees and argues that even though they were not used to compress gas, the facilities provided operational flexibility, helped maintain operationally available capacity at higher levels, helped offset unexpected losses at other stations, minimized or eliminated curtailments, avoided or reduced periods of strained or critical operating conditions, and were available during emergency situations. El Paso states that the Presiding Judge acknowledged that the Stations "may have been held in reserve (i.e., used) as emergency redundancy facilities during/throughout the test period." El Paso notes that Commission precedent establishes that the costs of a compressor station held in reserve or that helps ensure operational reliability may be included in pipeline rates.[69]

49. El Paso claims that the Commission's statements in the Abandonment Order support the notion that the facilities are not needed in the future and abandoning them will reduce El Paso's rates in the future. El Paso argues that the statements do not however have any bearing on when El Paso's rates should be reduced to reflect the costs

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[65] *Id*. at 93-94.

[66] *Tennessee Gas Pipeline Co.,* 73 FERC ¶ 61,368 (1995) (*Tennessee*).

[67] El Paso Rehearing at 94 (citing *Tennessee,* 73 FERC at 62,157).

[68] *Id*. at 94-95 (citing *Panhandle II*, Opinion No. 395, 71 FERC ¶ 61,228 at 61,825).

[69] *Id*.

saved by abandonment. El Paso therefore argues that the Commission's logic would mean that pipeline facilities placed in service after the test period should be included in the rates because they will be used when they go in service. El Paso argues that this practice would be contrary to Commission policy which states that new construction that is known but not yet in service within the test period may not be reflected in the rates.[70]

Commission Determination

50. The Commission denies rehearing and affirms its holding that the expenses associated with the Tucson and Deming Compressor Stations should be excluded from El Paso's cost of service. El Paso argues that the Commission's ruling violates the principle that a pipeline's rates should be based on the pipeline's costs incurred during the test period and is contrary to several cases in which the costs of facilities that were abandoned after the end of the test period were included in the pipeline's rates based on test period ratemaking.

51. El Paso argues that the Commission has rejected each of El Paso's proposed adjustments to test period costs or volumes in favor of actual test period costs and volumes; El Paso contends that the Commission inconsistently reached beyond the test period to remove from El Paso's rates the costs of facilities that were not abandoned until well after the test period. We disagree. The Commission findings on those issues are distinguishable from the instant issue. The Commission rejected El Paso's proposed normalization of compression station overhaul expenses based on cold snaps that delayed some overhauls during the test period because the Commission found that El Paso had not shown that the actual test period expenses were substantially in error.[71] Similarly, the Commission rejected El Paso's proposal to normalize its Periodic Maintenance Expense because it was based on estimated costs, not incurred costs.[72] In contrast, the costs related to the Tucson and Deming Compressor Stations are actual costs that El Paso anticipated would be removed from its cost of service upon abandonment of the compressors. The Tucson and Deming Compressor Stations were not used to transport natural gas during the years before and during the test period and it would be an error to include these costs in this test period.[73] In the Abandonment Application El Paso

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[70] *Id*. at 96-97 (citing 18 C.F.R. § 154.303(c)(2) and *Florida Gas Transmission Co., LLC*, 130 FERC ¶ 61,250, at PP 43-45 (2010)).

[71] Opinion No. 528, 145 FERC ¶ 61,040 at P 62.

[72] *Id.* P 63.

[73] *Id.* P 185 (citing Abandonment Application at 6).

characterized the stations as functionally obsolete and no longer able to provide service as of September 28, 2010, before the end of the test period.[74]

52. The Commission can reach beyond the test period if changes occurring after the test period are of a substantial nature and would correct estimates that were substantially in error. El Paso believes that standard was not met.[75] We disagree. Allowing the costs of the abandoned stations to be removed from the cost of service is reasonable in the instant proceeding. El Paso stated in its abandonment application filed during the test period that those facilities were no longer used to provide jurisdictional services. The fact that the Commission did not grant the abandonment until after the end of the test period does not alter the fact that the Compressor Stations were not used to provide service during the test period. Moreover, El Paso stated in its Abandonment Application that any rate impact "should be reflected in El Paso's September 30, 2010 rate case filing."[76] In addition, El Paso argues that, if the Commission requires these costs to be removed from the cost of service due to that the fact that the grant of the abandonment occurred after the test period, it can include the costs of other facilities or billing determinant reductions that occurred after the end of the test period. We disagree. Here, we are disallowing the compressor costs because of an event that occurred before the end of the test period – El Paso's ceasing to use those facilities to provide service. The other examples cited by El Paso are not similarly tied to changes occurring before or during the test period.

53. The cases cited by El Paso are distinguishable from the instant proceeding. *Tennessee*[77] is distinguishable because the Tennessee facilities were abandoned by sale to Chevron. Before the abandonment by sale, the facilities in *Tennessee* were still producing gas;[78] the abandonment was not based on the facilities not being used. Therefore, it would not have been reasonable to exclude the cost of Tennessee's facilities from the cost of service in the pending rate case when the facilities were in use during the test period prior to the abandonment by sale. In the instant case, the Compressor Stations

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[74] *Id*. PP 172 and 185 (citing Ex. EPG-298 at 4 and Abandonment Application at 7).

[75] El Paso Rehearing at 93.

[76] Opinion No. 528, 145 FERC ¶ 61,040 at PP 171 and 185 (citing Ex. SCG-56 at 15 and Abandonment Application at 12).

[77] *Tennessee*, 71 FERC ¶ 61,072, *clarified*, 73 FERC ¶ 61,368 (1995).

[78] *Tennessee*, 71 FERC at 61,427.

were deemed by El Paso to be functionally obsolete and not used for natural gas transportation before the 2011 Rate Case application was even filed.

54. El Paso argues that *Panhandle* is not distinguishable from the instant case because the El Paso Compressor Stations were in fact used during the test period by providing operational flexibility and reliability, just as those in *Panhandle* were used for part of the test period. El Paso's argument is in stark contrast to its many statements in the Abandonment Application that the facilities were functionally obsolete and no longer provided service as of September 28, 2010. El Paso also represented to the Commission in its Abandonment Application that the Compressor Station costs would not be reflected in the rates in the 2011 Rate Case.[79] In addition, El Paso's reliance on *Wyoming Interstate*[80] and *Eastern Shore*,[81] where the Commission has allowed costs of facilities used for operational reliability to be included in pipeline rates, is inapt. Those facilities were built for the express reason to increase reliability, unlike the instant case in which the cost of the Compressor Stations remained in the cost of service due to a regulatory requirement.[82]

55. El Paso incorrectly argues that the Commission's cites to statements El Paso made in its Abandonment Application should have no bearing on when El Paso's rates should be reduced to reflect the costs saved by the abandonment.[83] However, the Abandonment Application states that the Compressor Stations have not served any real function related to the transportation of natural gas for a number years and the abandonments should be reflected in this proceeding.[84] Since a fundamental purpose of test period ratemaking is to establish a representative going-forward cost of service;[85] including the costs of the abandoned Tucson and Deming Compressor Stations in the cost of service would be a

[79] Opinion No. 528, 145 FERC ¶ 61,040 at PP 172 and 185 (citing Ex. EPG-298 at 4 and Abandonment Application at 5, 7, and 12).

[80] *Wyoming Interstate*, 76 FERC ¶ 61,252.

[81] *Eastern Shore*, 76 FERC ¶ 61,358.

[82] Opinion No. 528, 145 FERC ¶ 61,040 at P 185 (citing Abandonment Application at 6 and 7).

[83] *Id.*

[84] *Id.* (citing Abandonment Application at 5, 7, and 12).

[85] *Id.* P 171 (citing Initial Decision, 139 FERC ¶ 63,020 at P 125).

disservice to El Paso's customers. El Paso also relies on the technicality of a delayed Commission order to argue that the abandoned Compressor Station costs should remain in its cost of service and be recovered in its rates despite the fact that those facilities were not used to provide services during the test period. A mere technicality should not prevent El Paso from implementing the cost savings that were contemplated in the Abandonment Application.

56. El Paso attempts to support this claim by citing to the converse of this situation—i.e., the idea that pipeline facilities placed in service after the test period should be included in the rates because they will be used when they go in service.[86] We find this comparison unavailing. New construction involves many unknowns, especially the exact date when facilities will be placed in service. In the instant case, the obsolescence and abandonment of the Compressor Stations has been established and was known prior to the end of the test period. In these circumstances, the fact that the Abandonment Application was not granted until after the end of the test period is a mere technicality that should not prevent a significant decrease in the cost of service that was contemplated by El Paso in its Abandonment Application. Therefore, consistent with *National Fuel*,[87] the Commission denies rehearing and affirms its finding requiring El Paso to exclude from its cost of service the costs related to the abandoned Tucson and Deming Compressor Stations.

C. Cost Allocation and Rate Design

1. Zone of Delivery Rates

a. Background

57. In its September 30, 2010 NGA general section 4 rate filing, El Paso proposed to continue to use its existing zone-of-delivery rate design.[88] Under this methodology, rates are established for state-wide delivery zones - California, Nevada, Arizona, New Mexico, and Texas - and shippers pay the same rate to deliver natural gas to any point within the zone. El Paso's existing zone rates generally increase in modest increments from east to west.

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[86] El Paso Rehearing at 97.

[87] *National Fuel*, 51 FERC ¶ 61,122 at 61,334 (footnotes omitted).

[88] *See* El Paso Transmittal Letter at 3.

58. In this rate case, El Paso stated that its studies indicate that distance has a modest effect on cost responsibility and that contract paths effectively specify a shipper's capacity rights and have real economic value.[89] El Paso first classified its transmission costs as either fixed or variable and then as non-mileage-based or mileage-based.[90] El Paso further stated that all of its variable costs are treated as mileage-based and recovered through its delivery-zone usage charges.[91] 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 use discount-adjusted billing determinants in its Dth-mileage study.

59. El Paso proposed to determine the mileage used in its Dth-mileage study based 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 the same model it developed for use in its last two rate cases, as updated for test period information.[92] That model 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.[93] 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.[94] 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.[95]

60. 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

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[89] El Paso Initial Br. at 70 (citing Ex. EPG-224 at 33-46).

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

[91] El Paso Initial Br. at 89.

[92] Ex. EPG-107 at 21.

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

[94] *Id.* at 23.

[95] *Id.* at 7.

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. 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.[96]

61. After calculating rates for each zone pursuant to the above methodology, El Paso proposed to "equilibrate" the rates for the California, Arizona, and Nevada rate zones by averaging the rates for the three zones into a single rate, while maintaining separate zonal rates for New Mexico and Texas.[97] El Paso stated that the practical impact of this part of its proposal is to slightly raise the rate in the Arizona zone and to slightly lower the rate in the California zone.[98] El Paso stated that "while distance of haul should be de-emphasized as a cost factor on the [El Paso] system, a switch to a postage stamp rate design is not appropriate at this time. [El Paso's] proposed rate design reflects an appropriate balance at this time between a pure distance sensitive and a postage stamp rate design."[99]

62. ACC/Southwest Gas, APS, Texas Gas Service[100] and Trial Staff supported the zone-of-delivery methodology but argued for certain modifications. On the other hand, Edison and SoCal Gas/San Diego contended that El Paso's proposed zone-of-delivery methodology, with its contract-path methodology, failed to recognize that the distance that natural gas is transported on El Paso's system is not a material factor affecting the cost of transportation and therefore proposed the use of a postage-stamp methodology.

63. In addition, during the course of the proceeding, several parties proffered alternative or "back-up" positions. For example, El Paso stated that "if the Commission were to decide in this case that [El Paso's] filed, zone of delivery rate design is no longer just and reasonable, the proper rate design to install in its place would be a postage stamp

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

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

[98] El Paso Initial Br. at 76.

[99] Ex. EPG-175 at 26.

[100] *See* Texas Gas Service, August 4, 2014 Notice of Withdrawal, and July 1, 2014 Settlement in Docket No. RP14-1088-000.

design."[101] Edison and SoCal Gas/San Diego argued that if the Commission does not adopt postage-stamp rates for El Paso, it should at least approve El Paso's zone equilibration proposal.[102] In addition, assuming arguendo that distance-sensitive rates are appropriate, Edison argued that the zone-of-delivery methodology is unreasonable because it averages together all contracts for transportation to the same delivery zone, regardless of the receipt point where the transportation begins.[103]

64. In Opinion No. 528, the Commission affirmed the Presiding Judge's approval of El Paso's zone-of-delivery methodology for allocating mileage-related costs as just and reasonable, and his rejection of El Paso's proposal to "equilibrate" the rates for the California, Arizona, and Nevada zones.[104] Opinion No. 528 also affirmed the Presiding Judge's finding that El Paso's proposed contract-path methodology for allocating mileage-related costs is just and reasonable. Further, Opinion No. 528 found that it is appropriate to use contract paths because they represent specific routes along El Paso's pipeline system by which natural gas can be transported from the shipper's receipt point (or pool) to its delivery point.[105] Further, they represent paths which are not subject to prior claim by any other shipper.[106] In addition, Opinion No. 528 found that El Paso provided substantial evidence to support its proposal, providing a Dth-mileage study 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.[107] The Commission described the supporting Dth-mileage study as a practical cost-tracking method and the proposed rate design as reflecting moderate, but reasonable,

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[101] Ex. EPG-224; Tr. 1448:18-25 (Derryberry); El Paso Initial Br. at 84.

[102] Edison Brief on Exceptions at 58; SoCal Gas/San Diego Brief on Exceptions at 25.

[103] Edison Rehearing at 49-50.

[104] *See* Opinion No. 528, 145 FERC ¶ 61,040 at PP 260, 274 (citing Initial Decision, 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.

[105] Opinion No. 528, 145 FERC ¶ 61,040 at P 243 (citing Ex. EPG-224 at 9, 34, 45).

[106] *Id.* P 243 (citing Ex. EPG-224 at 34; 18 C.F.R. § 284.8(a)(3)).

[107] *Id.* (citing Ex. EPG-107 at 17-29).

differences in rates due to distance sensitivity.[108] However, the Commission also rejected as empirically unsupported El Paso's proposal to change its cost allocation methodology by assigning positive mileage to contra flows for the production area zone, in light of the detailed information in its Dth-mile study.[109]

65. The Commission noted that there was no disagreement among the parties that El Paso operates an integrated system and that displacement plays an important role in the operation of El Paso's system.[110] In response to Edison's argument that the zone-of-delivery methodology unreasonably averages together all contracts for transportation to the same zone, the Commission found 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.[111] Further, the Commission found that 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.[112] The Commission rejected Texas Gas Service's and Trial Staff's suggestion to use actual usage as opposed to contract paths to allocate fixed costs, finding instead that El Paso's long-standing contract-path methodology is consistent with the Commission's market restructuring policies.

66. As described more fully below, Opinion No. 528 reversed the Presiding Judge on one issue concerning El Paso's Dth-mileage study. While the Presiding Judge accepted El Paso's proposal to use discount adjusted billing determinants in that study, the Commission rejected that proposal and required El Paso to use unadjusted billing determinants.

67. With respect to the proposed postage-stamp proposals, Opinion No. 528 affirmed the Presiding Judge's finding that those proposing postage-stamp rates did not meet 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.[113] However, the Commission

[108] Ex. EPG-107 at 30.

[109] Opinion No. 528, 145 FERC ¶ 61,040 at P 328.

[110] *Id.* P 247.

[111] *Id.* P 251 (citing Ex. EPG-224 at 23-33).

[112] *Id.* (citing Ex. EPG-224 at 28).

[113] *Id.* P 260 (citing Initial Decision, 139 FERC ¶ 63,020 at P 156).

acknowledged that postage-stamp rates for transportation services might also be just and reasonable, if proposed under NGA section 4.

b. Burden of Proof

Request for Rehearing

68. Edison contends that the Commission's acceptance of El Paso's zone-of-delivery rate design proposal, while rejecting its zone equilibration proposal, incorrectly, and unlawfully, blurred the lines between NGA sections 4 and 5 by imposing a rate design that was not proposed by El Paso.[114] Edison further contends that the Commission erred by not satisfying its burden of proof under section 5 of the NGA.[115]

Commission Determination

69. In Opinion No. 528, the Commission affirmed the Presiding Judge's findings that El Paso satisfied its section 4 burden to show that its use of the contract-path method of allocating mileage-based costs as part of its zone-of-delivery rate design is just and reasonable,[116] but did not satisfy that burden with respect to the zone equilibration proposal. Edison contends that, by rejecting one aspect of El Paso's proposed zone-of-delivery rate design, but accepting the remainder of the proposal, the Commission "move[d] beyond rejection of a proposed rate to the task of redesigning it."[117] Therefore, Edison argues, the Commission must act under NGA section 5 in order to require El Paso to use its zone-of-delivery rate design without its equilibration proposal. We disagree.

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[114] Edison Rehearing at 18 (citing *Public Serv. Comm'n of NY*, 866 F.2d 487, at 488-89 (D.C. Cir. 1989); *Western Resources, Inc. v. FERC*, 9 F.3d 1568, 1578 (D.C. Cir. 1993) (*Western Resources*); *Consolidated Edison Co. of NY v. FERC*, 165 F.3d 992, 1101 (D.C. Cir. 1993) (*Consolidated Edison*); *Consumers Energy Co. v. FERC*, 226 F.3d 777, 780-81 (D.C. Cir. 2000)).

[115] Edison Rehearing at 19, 21-22.

[116] The Presiding Judge found that El Paso has the burden under NGA section 4 to show that its contract-path method of allocating mileage-based costs is just and reasonable, because the prior two rate cases in which El Paso proposed that method ended in settlements, and thus the Commission has not previously approved that methodology on the merits. Initial Decision, 139 FERC ¶ 61,020 at P 157.

[117] *Western Resources*, 9 F.3d at 1579.

70. In *Western Resources,* the court held that NGA section 5 "governs situations in which the Commission imposes rates of its own creation."[118] The court further held that, in order for the Commission to impose its own rate in a pipeline's section 4 rate proceeding the Commission "must make three findings: first, it must conclude under section 4 that the pipeline failed to carry its burden of proof that the proposed rate was just and reasonable; second it must itself demonstrate that the default position, the prior rate, is no longer just and reasonable; and third, it must establish that its substitute rate is just and reasonable."[119]

71. In this NGA section 4 rate case, El Paso proposed one fundamental change to its longstanding zone of delivery rate design: the equilibration of the rates for the California, Arizona, and Nevada rate zones into a single rate applicable to all three rate zones. Aside from that change, El Paso did not propose any other change in the methodology it had used to determine the zone of delivery rates it proposed in its last two section 4 rate cases. As its witness testified, the contract path method of allocating mileage-based costs El Paso used in its section 4 rate proposal in this rate case is based on "the same model [El Paso] developed for use in its last two rate cases in Docket Nos. RP05-422 and RP08-426."[120]

72. In finding that El Paso has not carried its NGA section 4 burden to show that its proposal to equilibrate its three western rate zones is just and reasonable, we have not moved beyond rejection of El Paso's section 4 rate change proposal to impose a rate of our own creation under NGA section 5. Pursuant to *Western Resources*, when we reject a pipeline's section 4 proposal to modify its rate design, the pipeline's rates must return to the "default position" of the prior rate design, unless we act under NGA section 5 to find the prior rate design unjust and unreasonable and show that our preferred rate design is just and reasonable. In the circumstances of this case, the Commission finds that

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[118] *Id.* at 1578.

[119] *Id*. at 1579. *See also Tennessee Gas Pipeline Co. v. FERC*, 860 F.2d 446, 455 (D.C. Cir. 1988), stating,

> Section 4 limits the Commission's authority to acceptance (in whole or in part) or rejection of the pipeline's proposed rates; the section does not authorize FERC to substitute rates of its own design for the rates proposed by the pipeline. This restriction guarantees that the rates generally will be set, in the first instance, by the pipelines themselves…

[120] Ex. EPG-107 at 21.

El Paso's contract path method of allocating mileage-based costs among its existing rate zones is reasonably considered to be part of El Paso's existing zone-of-delivery rate design methodology, and thus part of the "default position" that must apply absent our satisfying the requirements of NGA section 5 to impose a rate of our own creation.[121]

73. After the Commission approved El Paso's establishment of contract paths for its customers in 2004,[122] El Paso proposed to use the contract path method of allocating mileage-based costs in its next two rate cases, as well as this one. While the first two rate cases ended in settlements with the result that the Commission did not address the merits of the contract path methodology, no party has suggested any other method of allocating mileage-based costs that could be considered part of El Paso's existing zone-of-delivery rate design methodology for purposes of applying the three-part burden of proof *Western Resources* requires us to satisfy before imposing a rate of our own creation. In fact, we have not found in the record a description of any other method El Paso may have used to allocate mileage-based costs prior to the establishment of contract paths in 2004.

74. Moreover, while Edison and SoCal Gas/San Diego have sought rehearing of our rejection of El Paso's equilibration proposal and approval of El Paso's contract path method of allocating mileage-based rates, El Paso has not. The only zonal rate design issue upon which El Paso has sought rehearing is Opinion No. 528's requirement that costs should be allocated across zones based on the contract demands of shippers in each zone unadjusted for discounting, and below we grant El Paso's request for rehearing on that issue. Thus, the zone of delivery rate design approved in this order has been consented to by El Paso. In these circumstances, we find that our actions with respect to El Paso's zone of delivery rate design fall within the ambit of our NGA section 4 authority.[123] We have rejected El Paso's proposal under NGA section 4 to modify its existing zone of delivery rate design and, instead, required El Paso to continue to use the rate design methodology it used in its previous two rate cases, and El Paso has accepted that result. Contrary to Edison's assertions, these actions do not improperly blur the line between NGA sections 4 and 5. As the D.C. Circuit held in *City of Winnfield v. FERC*,[124]

[121] If we found that El Paso's contract path method of allocating mileage-based costs among its existing rate zones was unjust and unreasonable, we could under *Western Resources* move on to require El Paso to adopt a different method of allocating those costs pursuant to NGA section 5. However, as discussed later in this order, we find that the contract path method of allocating these costs is just and reasonable.

[122] *El Paso Natural Gas Co*., 109 FERC ¶ 61,292 (2004).

[123] *See Western Resources,* 9 F.3d 1586, 1579.

[124] 744 F.2d 871 (D.C. Cir. 1984).

involving similar provisions of the Federal Power Act, "The structure of the Act . . . is not 'undermined' or even threatened when, in a Sec. 205 proceeding [analogous to NGA section 4], the Commission declines to permit a new form of rate calculation but grants a rate increase under the form the utility has previously been using, which increase the utility accepts." Edison's request for rehearing on this issue is denied.

c. Whether Zone-of-Delivery Methodology is Just and Reasonable

Requests for Rehearing

75. SoCal Gas/San Diego and Edison contend that the Commission erred in affirming the Presiding Judge's holding that El Paso's proposed zone-of-delivery cost allocation methodology is just and reasonable. SoCal Gas/San Diego contend that a rate structure with rates increasing incrementally east-to-west is no longer just and reasonable when two-thirds of the system's mainline natural gas supplies are transported north-to-south from the San Juan Basin.[125] SoCal Gas/San Diego argue that a mileage-based cost allocation methodology assumes that transportation costs increase per mile, per unit of throughput. They further argue that because that assumption has been proven false with respect to deliveries to California, it would be arbitrary.[126]

76. SoCal Gas/San Diego, noting that Opinion No. 528 references the important role that displacement plays on El Paso's system, argues that if the "Commission takes this to mean that it is free to ignore a material difference in cost causation between shippers or rate zones based on their relative unit costs of service, and to focus only on the flawed attempt to establish miles of haul as a basis for cost allocation it is elevating form over substance to an arbitrary and capricious degree."[127]

77. Edison reiterates its arguments that the historical zone-of-delivery methodology is unjust, unreasonable and unduly discriminatory because the rates paid by shippers are based entirely on the state in which the natural gas is delivered, regardless of the source of the natural gas where the transportation begins.[128] Edison again argues that the

[125] SoCal Gas/San Diego Rehearing at 16-19.

[126] *Id.* at 26 (citing *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto Ins. Co.*, 463 U.S. 29, 43 (1983)).

[127] SoCal Gas/San Diego Rehearing at 27.

[128] Edison Rehearing at 38, 48.

starting point for transportation became especially meaningful following the Commission's finding in the Capacity Allocation Complaint Order that required El Paso to allocate specific primary receipt points to its contracts.[129]

Commission Determination

78. The Commission re-affirms its finding in Opinion No. 528 that El Paso's zone-of-delivery methodology is a just and reasonable methodology for allocating mileage-related costs on El Paso's system. Further, as discussed in more detail below, the Commission re-affirms its finding that El Paso's proposed contract-path methodology for allocating mileage-related costs is just and reasonable.

79. Edison and SoCal Gas/San Diego contend that changes in the overall direction of natural gas flows on El Paso's system make El Paso's zone-of-delivery rates unjust and unreasonable. They also contend that rates derived from a mileage-based allocation should increase with distance. The Commission agrees that on a theoretical basis, rates should increase with distance, all other things being equal. However, the operations of El Paso's system are not theoretical; contra-flows complicate the development of mileage studies. El Paso's witness Rezendes, recognizing the complications caused by contra-flows, testified that she considered three different options to address this issue.[130] For all areas except the production area, she selected the option which assigned zero mileage to contra-flows, to recognize a modest sensitivity in miles of haul along the pipeline system and reflect some benefits of backhauls and displacements, without implying that contra-flows provide direct fixed cost savings to the system. In the production area, she chose to use the positive mileage option because flows in the production area are done on a forward-haul basis.[131] Opinion No. 528 found that El Paso provided a reasonable method to account for contra-flows.[132] Based on El Paso's detailed analysis, the Commission finds that SoCal Gas/San Diego's claim that Opinion 528's finding is arbitrary is without merit.

[129] Edison Brief on Exceptions at 29-40 and Edison Rehearing at 48-57 (both citing *El Paso Natural Gas Co.,* 99 FERC ¶ 61,244, at 61,997 (2002) (Capacity Allocation Complaint Order)).

[130] Ex. EPG-107 at 25-26.

[131] *Id.* at 26-27.

[132] Opinion No. 528, 145 FERC ¶ 61,040 at P 243.

80. SoCal Gas/San Diego are concerned that the Commission ignored the importance of the role of displacement on El Paso's system. Opinion No. 528 did not ignore the importance of the role of displacement. Rather, it found that "El Paso exploits displacement opportunities to maximize operationally available capacity and reduce operating costs, such as those incurred for fuel and compression."[133] However, the fact that the Commission acknowledges displacement falls short of endorsing the idea that displacement supports rejecting cost causation principles that underlie El Paso's modestly distance sensitive rates. Thus, the contention that Opinion No. 528 elevated form over substance is simply not true.

81. Edison reiterates its position that El Paso's zone-of-delivery methodology unreasonably averages together all contracts for transportation to the same delivery zone, regardless of the receipt point. Edison again argues that the starting point became especially meaningful following the Capacity Allocation Complaint Order that required El Paso to allocate specific primary receipt points to its contracts. In the Capacity Allocation Complaint Order the Commission found that El Paso's *pro rata* allocation of system-wide receipt points was unjust and unreasonable because firm shippers were not receiving reliable firm service. Therefore, the order directed El Paso to modify its capacity allocation methodology to ensure greater predictability for firm shippers.[134] With respect to receipt points, the Commission found that "pooling allows broader access to supply aggregation necessary to accommodate shippers' needs for both competitive prices and supply reliability."[135] Thus, contrary to Edison's contention, the Capacity Allocation Complaint Order specifically addressed the issue of receipt point pooling and the findings in Opinion No. 528 are consistent with that ruling. With respect to averaging contracts to the same delivery zone, El Paso notes that having a single rate "assures fair and even treatment of all transactions to the same state."[136] Further, as explained in Opinion No. 528, 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.[137] Based on this analysis, the Commission denies rehearing on this issue.

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[133] *Id.* P 247 (citing Ex. EPG-145 at 4).

[134] Capacity Allocation Complaint Order, 99 FERC ¶ 61,244 at 61,997.

[135] *Id.* at 62,015-62,016.

[136] Ex. EPG-224 at 28-29.

[137] Opinion No. 528, 145 FERC ¶ 61,040 at P 251 (citing Ex. EPG-224 at 28).

d. Use of Contract Paths for Allocating Mileage-Related Costs

Requests for Rehearing

82. Edison and SoCal Gas/San Diego request rehearing of Opinion No. 528's finding that El Paso's proposed contract-path methodology for allocating mileage-related costs is just and reasonable. SoCal Gas/San Diego argue that because the mileages for a number of the contract paths include contra-flows and because the actual miles of haul cannot be reliably established, then a mileage-based cost allocation methodology is not just and reasonable.[138] Similarly, Edison argues that the level of contracted service says nothing about the distance natural gas is transported for a given contract and therefore is "unfathomable" for purposes of cost allocation.[139] In addition, Edison argues that rates must be designed with a "focus on actual operations" and that distance-based rates must "reasonably reflect any material variation in the cost of providing the service due to… (ii) the distance over which the transportation is provided." Edison also argues that El Paso did not examine the costs caused by service to specific contracts over specific contract paths and that natural gas can physically flow over a variety of paths.[140]

83. Edison and SoCal Gas/San Diego disagree with Opinion No. 528's findings about the correlation of natural gas flows on El Paso's system and contract paths. SoCal Gas/San Diego note that El Paso's witness did not say that natural gas can physically flow over all or even most of the contract paths, but rather, that El Paso's system has the ability to physically flow natural gas to satisfy all its firm pathed contract demand when the system is operating at full capacity.[141] Similarly, Edison contends that El Paso's contracted quantities of capacity reflect the level of service that El Paso is obligated to provide, which is independent of the contract path.[142] Edison further notes that on an average day, there is no relationship between the contract path and the flow on that day.[143] In fact, Edison notes that El Paso's contract-path methodology assigns

[138] SoCal Gas/San Diego Rehearing at 19-27.

[139] Edison Rehearing at 40-41, 48.

[140] *Id.* at 38-48.

[141] SoCal Gas/San Diego Rehearing at 22 (citing Ex. EPG-224 at 48).

[142] Edison Rehearing at 40-41.

[143] *Id.* at 41 (citing Tr. 1472:16-21 (Derryberry)). *See also id.* at 44.

dramatically different mileages to the same San Juan Basin to Phoenix receipt-point/delivery-point combinations for no cost-based or operational reasons.[144] Edison also contends that the fact that contract paths reflect the paths for capacity that can be released by shippers is meaningless because the contract path remains in place for the replacement shipper.[145]

84. SoCal Gas/San Diego disagree with Opinion No. 528's reasoning that El Paso's proposed contract paths "represent specific routes by which gas can be transported" or that the paths "closely resemble" actual flows at peak.[146] Moreover, Edison notes that because El Paso rarely operates at peak, allocating costs based on how the system would operate at peak is misguided.[147] SoCal Gas/San Diego note that El Paso's exhibit showing the mileage for the contract paths indicates that 49 percent of the contract paths contain contra-flow segments.[148] SoCal Gas/San Diego state that its witness' testimony estimated that El Paso uses displacement for approximately 30 percent of its deliveries on average.[149] Edison and SoCal Gas/San Diego note that the degree to which the contract paths approximate physical flows under peak load conditions across the north-to-south crossovers, is approximately 60-70 percent.[150] Further, SoCal Gas/San Diego note that the Commission misrepresented the testimony which stated that the contract paths simply ***approximated*** the distances actually reserved under certain conditions.[151]

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[144] *Id.* at 41-42 (citing Ex. SCE-1 at 25-26, Ex. EPG-118, and Ex. EPG-108; identifying schedule names).

[145] *Id.* at 43.

[146] SoCal Gas/San Diego Rehearing at 20 (citing Opinion No. 528, 145 FERC ¶ 61,040 at PP 243, 249).

[147] Edison Rehearing at 44.

[148] SoCal Gas/San Diego Rehearing at 23-26 (citing Ex. EPG 108).

[149] *Id.* at 24 (citing Ex. SCG-31 at 11).

[150] Edison Rehearing at 43-44 (citing Tr. 2617:11-2628:3 (Westhoff)); SoCal Gas/San Diego Rehearing at 21 (citing Ex. EPG-224).

[151] SoCal Gas/San Diego Rehearing at 20 (citing Ex. EPG-224 at 9, 33-34 (emphasis added by SoCal Gas/San Diego)). The Commission notes that although Opinion No. 528, 145 FERC ¶ 61,040 at PP 243 and 249 inaccurately used the words

(continued...)

85. Edison and SoCal Gas/San Diego note that El Paso's contract paths were the result of the orders on capacity allocation and complaints in the Capacity Allocation Proceeding[152] and El Paso's Order No. 637 compliance proceeding and were never developed or approved for the purpose of cost allocation.[153] Edison notes that El Paso's facilities were not constructed to serve particular customers or contract paths.[154] SoCal Gas/San Diego also contend that El Paso bears the NGA section 4 burden of proving that the use of contract paths to allocate costs is just and reasonable.[155]

Commission Determination

86. The Commission re-affirms Opinion No. 528's finding that El Paso's proposal to use contract paths to allocate mileage-related costs is just and reasonable. The Commission disagrees with the arguments that the contract-path methodology is inappropriate because the mileages cannot be reliably established, include contra-flows or reflect different distances for the same receipt point/delivery point combinations. El Paso witness Rezendes calculated the mileages for every receipt point/delivery point combination across El Paso's reticulated pipeline system. She divided her calculations into three phases or segments: Incremental Pool Segments, Intermediate Segments (large segments of pipeline between waypoints, which are major junctions where tariff-defined paths diverge from one another), and Delivery Segments.[156] Ms. Rezendes used these segments to determine the total mileage from a receipt location to a delivery location along a specific path:

"represent" and "closely resemble" instead of "approximate," the findings would not change had the correct word been used.

[152] *Capacity Allocation Complaint Order*, 99 FERC ¶ 61,244, *clarified*, 100 FERC ¶ 61,285 (2002), *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*).

[153] Edison Rehearing at 39, 45 (citing *El Paso Natural Gas Co*., 109 FERC ¶ 61,292 (2004)); SoCal Gas/San Diego Rehearing at 22-25 (citing *Capacity Allocation Complaint Order*, 99 FERC ¶ 61,244; *petition for review denied*, *ACC*, 397 F.3d 952).

[154] Edison Rehearing at 45-48.

[155] SoCal Gas/San Diego Rehearing at 23.

[156] Ex. EPG-107 at 21-23 (citing Ex. EPG-59). *See also* Ex. EPG-111.

> For each receipt-delivery combination along a unique path, I started with the Intermediate Segment measured from the receipt location to the first waypoint along the chosen path. I continued to add Intermediate Segments, traveling from waypoint to waypoint along the specified contractual path. When the last waypoint was reached, the Delivery Segment was added from the final waypoint to the delivery point. If the receipt point was a pooling area, I added the Incremental Pool Segment mileage as well. So each receipt-delivery-path combination was made up of one or more Intermediate Segments, exactly one Delivery segment, and possibly an Incremental Pool Segment.[157]

87. Although most distances were based on actual mileages, some averaging was used. For example, in Incremental Pool Segments, Ms. Rezendes calculated a weighted average mileage for the entire pooling areas based upon actual flows from calendar year 2009 at each of the receipt locations.[158] For non-production segments with contra-flows, she applied a mileage of zero.[159] For production area segments, she applied a positive mileage because natural gas flows predominantly in a forward-haul direction, with little, if any, reliance on backhaul or displacement.[160]

88. El Paso witness Derryberry explained why El Paso's mileage study had different mileages for the same receipt point/delivery point combinations. He stated, "[t]here can be no doubt that most gas coming from one location and delivered to another location has more than one physical flow option on [El Paso's] system. In fact, the existence of different routes having different mileages is a product of [El Paso's] reticulated system…."[161] He further explained that on a typical day, El Paso will dispatch deliveries to achieve the most efficient possible use of the system and maximize the use of displacement.[162] With respect to San Juan Basin to Phoenix deliveries, Mr. Derryberry

[157] Ex. EPG-107 at 23-24.

[158] Ex. EPG-107 at 24.

[159] Ex. EPG-107 at 26.

[160] Ex. EPG-107 at 27.

[161] Ex. EPG-224 at 38.

[162] Ex. EPG-224 at 35-36 (citing Ex. EPG-226).

explained that when demand in Phoenix is low, El Paso's dispatchers will first maximize deliveries through the northern mainline and then south over the Maricopa Lateral. However, due to the 100,000 Dth/day capacity of the lateral, part of the Phoenix load must be served off the south mainline. He explained that as demand in Phoenix grows, there is even greater reliance on deliveries from the south mainlines and when demand is at its peak, natural gas may reach Phoenix from three directions using physical flows – (i) from the north mainline via the Maricopa Lateral, (ii) via the Havasu Crossover and then eastward on the south mainline from Wenden and (iii) using southwestward flows on the San Juan-Permian Crossover and then westward on the mainline.[163] The Commission finds that El Paso's mileage studies were meticulously prepared, that the assumptions underlying the studies are reasonable and the differences in mileages between the same receipt point/delivery point combinations reflect operational limitations on El Paso's system.

89. The Commission also disagrees with the arguments that the contract paths should not be used for allocating distance-based costs because contract paths do not reflect cost incurrence or actual/average activity on El Paso's system. El Paso proposed the use of contract paths because they reflect shippers' rights to capacity along specified paths.[164] Indeed, El Paso's proposed cost-allocation methodology "seeks to measure each shipper's relative cost responsibility for the capacity that has been reserved to serve that shipper."[165] As Mr. Derryberry explained:

> Because a shipper is able to rely on its contract paths when they are needed most, at the peak, I believe such paths provide a more accurate measure of the facilities [needed] to serve the shipper, and the associated distance of haul, than the 'typical' flows.… In fact, reliance on typical, or average, flows may well understate the capacity – and therefore the related mileage – needed to serve a particular shipper. For the same reason that the Commission requires use of a shipper's contract demand to measure capacity rights, rather than its average usage, using contract paths that reflect the shipper's capacity requirements at the peak is a more appropriate way to measure the distance through the system associated with the shipper's service, for the purpose of

[163] Ex. EPG-224 at 36-37.

[164] Ex. EPG-224 at 39.

[165] Ex. EPG-224 at 41.

> allocating the fixed transportation costs associated with that service. Moreover, … the use of contract paths assures that the cost allocation process will take into account all parts of the system used to provide a service, consistent with the integrated nature of [El Paso's] system operations.[166]

90. The Commission finds that El Paso's proposal results in rates that reasonably reflect material variations in the cost of providing service due to distance. Accordingly, the Commission finds that El Paso's proposal to use contract paths for allocating distance-based costs is just and reasonable because contract paths reflect shippers' rights to capacity along specified paths at peak times.

91. Opinion No. 528 found that contract paths represent the capacity (or portions thereof) that can be released by shippers.[167] Opinion No. 528 also found that 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.[168] Edison disagrees with these findings, arguing that the fact that contract paths reflect the paths for capacity that can be released by shippers is meaningless because the contract path remains in place for the replacement shipper. The Commission reaffirms its finding on this issue. Some portions of El Paso's system are in high demand. As El Paso notes, if a shipper's contract right is on a highly-demanded portion of the system, the releasing shipper can potentially command a higher price in the capacity release market than a shipper with only secondary rights to such capacity.[169] Thus, the value of the highly-demanded portion of the system is not meaningless.

92. In their requests for rehearing, Edison and SoCal Gas/San Diego note that El Paso's contract paths were the result of the orders in the Capacity Allocation Proceeding and El Paso's Order No. 637 compliance proceeding and were never developed or approved for the purpose of cost allocation. Edison further argues that El Paso's facilities were not constructed to serve particular customers or contract paths. On these points, the Commission concurs. The findings in Opinion No. 528 and in this order are not dependent on those earlier proceedings. Rather, they are based on the fact

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[166] Ex. EPG-224 at 41-42.

[167] Opinion No. 528, 145 FERC ¶ 61,040 at P 245.

[168] *Id.* P 245.

[169] Ex. EPG-224 at 46.

that in this NGA section 4 proceeding, El Paso set forth and defended a just and reasonable methodology for allocating distance-sensitive costs.

e. <u>Discount-Adjustment for Cost Allocation</u>

93. El Paso proposed to use the same discount-adjusted billing determinants in the Dth-mile study underlying its zone-of-delivery cost allocation methodology as it proposed to use in designing its per unit rates. The Presiding Judge accepted this proposal, finding that the same volumes should be used for both cost allocation and rate design purposes.

94. Opinion No. 528 reversed the Presiding Judge's decision on this issue. Instead, the Commission accepted an ACC/Southwest Gas proposal that costs should be 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.[170] The Commission relied on *Williston Basin*[171] to find that El Paso should allocate costs among its rate zones using unadjusted billing determinants and should not thereafter reallocate costs using adjusted billing determinants to reflect discounted volumes. In *Williston Basin*, the Commission stated that, generally speaking, the allocation of costs is a separate step in computing rates from the design of per unit rates, and the Commission set forth a general policy of allocating costs based on unadjusted billing determinants, specifically citing the example of long-line pipelines that have rate zones.[172] In Opinion No. 528, the Commission applied this policy to El Paso, explaining that 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.

95. While Opinion No. 528 required El Paso to allocate costs among rate zones based on unadjusted billing determinants, Opinion No. 528 affirmed the Presiding Judge's acceptance of El Paso's proposal to reflect a full discount adjustment in the billing determinants used to design its per unit rates.[173] The Commission noted that El Paso

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[170] Opinion No. 528, 145 FERC ¶ 61,040 at P 252 (citing *Williston Basin Interstate Pipeline Co.*, 107 FERC ¶ 61,164, at PP 82, 91 (2004) (*Williston Basin*)); Initial Decision, 139 FERC ¶ 63,020 at PP 168-173.

[171] *Williston Basin*, 107 FERC ¶ 61,164 at P 91.

[172] *Id.* P 82.

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

operates an integrated system, so all customers benefit from the facilities of the entire system.[174]

96. In this section, we address the parties' requests for rehearing of our rejection of El Paso's proposal to use discount-adjusted billing determinants in its Dth-mile study. Later in this order, we deny the requests for rehearing of our acceptance of El Paso's proposal to use a full discount adjustment to design its per unit rates.

Requests for Rehearing

97. El Paso seeks rehearing of the Commission's application of its policy favoring use of unadjusted billing determinants to reject El Paso's NGA section 4 proposal to use discount-adjusted billing determinants for cost allocation purposes. The Commission's holding requires El Paso to allocate costs among zones using unadjusted billing determinants, following the policy reflected in *Williston Basin*.[175] The Commission stated that El Paso should not thereafter reallocate costs using adjusted billing determinants to reflect discounted volumes.

98. El Paso, El Paso Electric, CPUC, Edison, Indicated Shippers, and SoCal Gas/San Diego seek rehearing of this determination and object to the resulting rate increase in zones where discounting is prevalent. El Paso, CPUC, Edison, and Indicated Shippers argue that the Commission's reliance on *Williston Basin* is misplaced because that case involved only allocation of discount costs between transmission and storage functions. El Paso, CPUC, and SoCal Gas/San Diego instead argue that the Commission should have followed precedent established in *Iroquois*,[176] which they cite as rejecting allocation of discount costs by zone. El Paso and SoCal Gas/San Diego assert that the Commission's action is inconsistent with its general rationale for upholding discount adjustments – that discounts benefit all customers by spreading fixed costs over a greater volume of billing determinants.

99. According to El Paso, the Commission's ruling allocates the benefits of discounts solely to zones other than California, but none of the burdens. El Paso objects to limiting discount adjustment cost recovery to the zone where the discount was granted, noting

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

[175] *Williston Basin*, 107 FERC ¶ 61,164 at P 91 (finding that cost of service should generally be allocated based on non-discounted volumes in order to properly match cost incurrence to cost causation).

[176] *Iroquois Gas Transmission System, L.P.*, 84 FERC ¶ 61,086 (1998) (*Iroquois*).

that, due to the rate impacts in the zones bearing such costs, no party advocated such a policy, absent some other proposal to mitigate the resulting cost increases. El Paso notes that its system is an integrated system and distinguishes the holding in *Williston Basin*, which separated transmission and storage function costs. According to El Paso, because it does not employ a "zone gate" system, it does not separately assign costs to zones.[177] Because there is no initial facility cost allocation by zone, El Paso argues that allocating discount costs by zone is not appropriate.[178]

100. El Paso cites testimony claiming that California costs would double if the ACC/Southwest Gas approach were adopted.[179] El Paso posits that limiting discount adjustments by zone could create stark rate differences, with the costs of discounts being borne by California shippers. In addition, El Paso outlines a scenario in which all shippers' costs could rise, due to the loss of discounted volumes, to an even greater extent than if the discounts were allowed.[180] El Paso contrasts the potential rate disparity as disproportionate to the relatively small difference in distance to serve the adjacent Arizona and California zones.[181] El Paso states that the proposal would shift approximately $20 million in discounted contract costs, but would allocate $50 million in revenues from the discounted contracts across the entire system. El Paso objects to what it characterizes as the substantial and unduly discriminatory impact on the California zone.

101. According to Indicated Shippers, *Iroquois* is more on point than *Williston Basin*, because it concerned a pipeline with costs allocated using a Dth-mile methodology. Indicated Shippers claim that the maximum recourse rate for California shippers will nearly double (up to 94 percent) and states that the Commission should have balanced the equities differently and determined that the adverse effects of its determination outweigh

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[177] Under the zone gate cost allocation methodology, direct costs, which can be identified by location (including plant and associated operating costs), are allocated to a zone based on location. Indirect costs, primarily A&G, are allocated based on their relationship to direct costs. *Williams Natural Gas Co*., 77 FERC ¶ 61,277, at 62,207 (1996).

[178] El Paso Rehearing at 17.

[179] *Id.* at 19 (citing Ex. EPG-390 at 32 citing Ex. SWG-1 at 99; SWG-11, Schedule 1, line 15).

[180] *Id.* at 21-23.

[181] *Id.* at 23.

potential benefits. CPUC concludes that the Commission should allocate discount costs on a system-wide basis, and asserts the Parties advocating limited discount recovery failed to meet their burden.

102. El Paso argues that the Commission's determination is inconsistent with the Commission's 1959 order on its last fully-litigated rate case, which relied on the Commission's finding that El Paso has an integrated system and must allocate costs on a system-wide basis. El Paso argues that the Commission ignored the findings of the Presiding Judge, and assigns greater cost responsibility to customers that were not responsible for the discounts. SoCal Gas/San Diego also argue that the Commission erred in not allowing for system-wide discount recovery, stating that the Commission's approach is inconsistent with El Paso's historical treatment of such costs and the Commission's policy on selective discounting.[182]

103. El Paso objects to the ruling as "effectively denying" it any opportunity to recover the costs at issue. El Paso requests the Commission clarify that the ruling can only be applied prospectively under section 5 of the NGA, because El Paso believes the ruling changes the existing practice on the El Paso system. Edison likewise criticizes the Commission for failing to make the requisite findings under section 5 before ordering the change to El Paso's discount allocation approach.[183]

104. El Paso Electric objects to the Commission's determination (and El Paso's original rate proposal) because it will result in a 49 percent reservation and demand rate increase. El Paso Electric argues that it is a captive customer, owning some generation that can only be served using natural gas delivered from El Paso. El Paso Electric objects to this increase as "too high" and claims that the Presiding Judge's requirement that this be shown by comparative data would be impossible to meet. El Paso Electric claims that comparative data is not required by Commission precedent to contest a rate increase and that the 49 percent rate increase it faces is "axiomatically" too high.[184]

105. El Paso Electric objects to bearing the cost of discounts caused by competition in California markets. El Paso Electric notes that California transportation costs are the most distance-sensitive costs. Consequently, the California discount adjustments require

[182] SoCal Gas/San Diego Rehearing at 4.

[183] Edison Rehearing at 6.

[184] *Id.* at 30.

reallocating a higher proportional share of distance-sensitive costs to the East-of-California rate zones.[185]

106. El Paso Electric claims that, absent mitigation, the Commission should have adopted the zone-by-zone remedy proposed by its witness Doering. Mr. Doering proposes to cap the discount adjustment at a percentage equal to California revenues divided by the value of California contracts at maximum tariff rates. El Paso Electric argues that there is no disincentive to El Paso discounting in California and passing the costs on to captive customers.

107. El Paso Electric claims that a full discount adjustment creates an unjust and unreasonable ratemaking incentive for El Paso to offer deep discounts and keep its facilities nominally used and useful. El Paso Electric reasons that the magnitude of El Paso's return on equity is directly related to rate base, and projects that El Paso can earn a greater profit by offering discounts than by taking facilities out of service and reducing its costs.[186] El Paso Electric argues that the Commission's Selective Discounting Policy does not preclude a pipeline from bearing some costs foregone in discounting and that rejecting recovery of some discount costs would be an incentive to abandon unneeded capacity.[187]

108. El Paso Electric criticizes the Initial Decision (and Opinion No. 528) as failing to evaluate alternative approaches to what it terms the "illegally severe level" of discount adjustment costs allocated to captive customers.[188] El Paso Electric cites precedent indicating that shareholders are not guaranteed cost recovery and argues that the Commission should require El Paso to bear a portion of the discount costs if it does not otherwise adopt mitigation rejected in Opinion No. 528.[189] El Paso Electric notes the

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[185] *Id.* at 27.

[186] *Id.* at 29.

[187] *Id.* at 35; *Policy for Selective Discounting By Natural Gas Pipelines*, 111 FERC ¶ 61,309 (*Selective Discounting Policy*), *reh'g denied*, 113 FERC ¶ 61,173 (2005) (*Selective Discounting Policy Rehearing Order*).

[188] El Paso Electric Rehearing at 35-36 (citing *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 612 (1944) (*Hope*) (Commission must balance investor and consumer interests) and *Jersey Central Power & Light Co. v. FERC*, 810 F.2d 1168, 1180-81 (D.C. Cir. 1987) (*Jersey Central*) (exploitative rates are illegal)).

[189] El Paso Electric Rehearing at 36 (citing *Natural Gas Pipeline Co. of America v. FERC*, 765 F.2d 1155, 1163-64 (D.C. Cir. 1985)).

49 percent proposed increase in its reservation and demand charges and claims that El Paso failed to offer any economic, cost-causation, or other regulatory justification for the large rate increases El Paso Electric must bear.

109. Based on the discounts and undersubscriptions, El Paso Electric proposes an exception to the Commission's abandonment and used and useful precedent for facilities that are no longer needed, but are not retired or otherwise abandoned, in opposition to El Paso's argument that it is entitled to recover all prudently-incurred costs.[190]

110. El Paso Electric cites other factual circumstances where cost recovery of otherwise prudently-incurred costs may be disallowed, including non-recurring costs, costs that violate the filed rate doctrine or prohibition of retroactive ratemaking, and costs that have not been established or relate to facilities not in service in the test period. El Paso Electric cites the take or pay proceeding as an example of cost sharing to resolve an industry liability.[191]

Commission Determination

111. The Commission grants rehearing on this issue, and affirms the Presiding Judge's holding accepting El Paso's proposal to use discount-adjusted volumes in its Dth-mileage study for purposes of allocating costs among rate zones.

112. The Commission recognizes that it stated in *Williston Basin* that a pipeline's "cost of service should generally be allocated based upon non-discounted volumes in order to properly match cost incurrence to cost causation."[192] However, *Williston Basin* also stated that we "are not inflexible with regard to any of the steps that culminate in final rates for pipeline services. At times, for equity reasons, we may deviate from usual practices in response to an alleged anomaly or unexpected result."[193] As an example of such a case, *Williston Basin* pointed to the Commission's prior decision in *Southern Natural*.[194] That case involved a situation in which competition required the pipeline to offer a disproportionate level of discounts in its Production Area Zone as compared to

[190] *Id.* at 37 (citing Initial Decision, 139 FERC ¶ 63,020 at P 263).

[191] *Id.* at 39-40.

[192] *Williston Basin*, 107 FERC ¶ 61,164 at P 91.

[193] *Id.* P 87.

[194] *Southern Natural Gas Co*., 65 FERC ¶ 61,348, at 62,842 (1993).

other rate zones. As a result, the pipeline's proposal to use unadjusted billing determinants for allocating costs among rate zones, while using discount-adjusted billing determinants to design per unit rates, resulted in more costs being allocated to that zone than could be recovered in that zone due to heavy discounting. The Commission found that this problem should be corrected by revising "Southern's cost allocation methodology to reflect the effects of discounting."[195]

113. The Commission finds that this case presents a similar situation as in *Southern Natural.* El Paso, like the pipeline in *Southern Natural*, has been required to offer a disproportionate level of discounts in its California and Within Basin zones, as compared to its other rate zones. As a result, using unadjusted billing determinants to allocate costs among zones, while using discount-adjusted billing determinants to design the per unit rates for each zones, creates an anomalous end result inconsistent with Opinion No. 528's goal of matching cost incurrence with cost causation. This is demonstrated by the information included in El Paso's filing to comply with Opinion No. 528.

114. El Paso's compliance filing includes separate calculations of its rates assuming (1) we deny rehearing and require it to use unadjusted billing determinants to allocate costs or (2) we grant rehearing and allow it to use discount-adjusted billing determinants. The chart below compares the results of those calculations, showing both the per unit zone rates that result from the alternative rate calculations and the percentage rate increases from El Paso's last approved just and reasonable rates.

El Paso Compliance Filing					
FT-1 Rate Comparison					
Rate Zones	Opinion 517-A rates (a)	Opinion 528 rates (b)	Rate impact: 517-A rates vs. Op. 528 w/o rehearing (c) = (b) / (a)	Opinion 528 rates w/ reh'g granted (d)	Rate impact: 517-A rates vs. Op. 528 w/ reh'g granted (e) = (d) / (a)

[195] *Id.*

FT-1 WB	3.0869	4.8996	59%	3.3829	10%
FT-1 TX	6.8010	8.1112	19%	8.8950	31%
FT-1 NM	8.0245	8.5254	6%	9.3559	17%
FT-1 AZ	10.6256	10.8726	2%	11.7942	11%
FT-1 NV	10.7319	11.1231	4%	12.1909	14%
FT-1 CA	10.8980	15.1828	39%	12.5875	16%

Column (a) rates are the rates accepted in Opinion No. 517-A, effective 1/1/09 – 3/31/11 (see Docket No. RP12-806-001 compliance filing, filed 8/17/15)

Column (b) rates reflect the findings of Opinion No. 528 (see Docket No. RP10-1398-000 Compliance Filing, Appendix B2-2, filed 12/16/13)

Column (d) rates assume rehearing is granted on discount cost allocation (see Docket No. RP10-1398-000 Compliance Filing, Appendix B2-2, filed 12/16/13)

115. As shown in the chart, using unadjusted billing determinants to allocate costs among rate zones results in per unit rates for the California, Nevada and Arizona zones of $15.1825, $11.1241 and $10.8726, respectively. This means that the per unit rate to California is $4.3102 (or 40 percent) higher than the rate to Arizona and $4.0597 (or 36 percent) higher than the rate to Nevada. However, El Paso's Dth-mile study found that the average mileage of the California shippers' contracts is only moderately higher than the average mileage of the shippers' contracts in the Nevada and Arizona zones. For example, El Paso found that the average miles of haul for the Arizona zone is 695 miles, while the average miles of haul for the California zone is 727 miles, only about 5 percent more than for the Arizona zone.[196] This would indicate that El Paso's costs of serving shippers in the California zone are only moderately higher than its costs of serving the Nevada and Arizona shippers, given that the greater distance of haul to California is the only basis that has been presented for finding that El Paso incurs more costs to serve California shippers than East of California shippers. This is particularly the case, since we have found that the costs of individual facilities on El Paso's integrated system should not be identified as serving a specific zone. In these circumstances, adopting rates for the California zone that are at least 37 percent higher than the rates for any other zone of El Paso's system would appear inconsistent with the ratemaking principle that cost responsibility should match cost causation.

116. Moreover, as shown in the chart, using unadjusted billing determinants to allocate costs among rate zones (when compared to the rates resulting from Opinion No. 517-A)

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[196] Ex. EPG-107 at 30.

leads to a 39 percent rate increase in the California rate zone and a 59 percent rate increase in the Within Basin zone, while the rate increases in the New Mexico, Arizona, and Nevada rate zones are only two to six percent. Such a wide disparity in the rate impacts in different rate zones as compared to the last approved just and reasonable rates would appear inequitable. The Commission's policy allowing discount adjustments in designing rates is based on the premise that a pipeline's offering of discounts to meet competition benefits a pipeline's captive customers by permitting the pipeline to obtain more billing determinants over which to spread its fixed costs. However, in this case, requiring El Paso to allocate costs among rate zones based on unadjusted billing determinants while using discount-adjusted billing determinants for rate design harms captive customers in the California zone by subjecting them to a 39 percent rate increase, and the Within Basin shippers suffer an even greater rate increase.

117. By contrast, granting rehearing will minimize these problems. As shown in the chart, using discount-adjusted billing determinants to allocate costs among rate zones will result in per unit rates for the California rate zone that are moderately higher than those for the Nevada, Arizona, and New Mexico rate zones. Also, the increases in the Within Basin and California zone rates are more in line with the rate increases in the other rate zones. While the rates in the Arizona rate zone, where Southwest Gas and other Arizona LDCs are located, will increase by a greater amount than if rehearing were denied, that rate increase is still limited to 11 percent. In general, the rate increases resulting from the fact competition requires El Paso to offer discounts are spread more evenly across its system when using discount-adjusted billing determinants. This is consistent with our finding that El Paso is an integrated system.

118. While Texas faces a 31 percent increase, its rates are not high in relation to the remaining rates on the El Paso system – remaining the second least expensive rate zone on the El Paso system. The increase brings the Texas rates closer to the rates in the neighboring Southwest States of New Mexico, Arizona, and Nevada. With this additional rate information provided in El Paso's Compliance Filing, we find that conditions on El Paso's system, particularly the fact it must offer disproportionate discounts in its California and Within Basin rate zones, justify an exception from the general policy that unadjusted billing determinants be used for cost allocation. Accordingly, we grant rehearing on this issue and affirm the Presiding Judge's acceptance of El Paso's use of adjusted billing determinants for cost allocation.

f. "Back-Up" Rate Design Proposals

Requests for Rehearing

119. SoCal Gas/San Diego contend that the Commission erred in rejecting both "El Paso's primary zone equilibration proposal," and what they describe as El Paso's "alternative postage stamp rate design proposal."[197] Edison also contends that the Commission should have approved El Paso's zone equilibration proposal.[198] Edison states that El Paso's approach "may lack intellectual or doctrinal purity; but it reflects [El Paso's] search for a reasonable end-result while recognizing the substantial merits of postage stamp rates."[199] Edison further asserts that El Paso proposed that, if its zone equilibration proposal was rejected, the Commission should adopt postage stamp rates, and Edison states that since "the Commission did not find [El Paso's] ***entire proposed approach*** to be just and reasonable, it should have considered the record to determine what alternative methodology would be just and reasonable."[200] El Paso did not request rehearing on this issue.

Commission Determination

120. The Commission denies rehearing. We disagree with SoCal Gas/San Diego and Edison's contentions that we should treat El Paso as having made an alternative proposal under NGA section 4 to adopt a single system-wide postage-stamp rate applicable to all rate zones,[201] if we reject El Paso's primary rate design proposal. We recognize that El Paso's witness Mr. Derryberry, made a general statement that, "if the Commission were to decide in this case that [El Paso's] filed, zone of delivery rate design is no longer just and reasonable, the proper rate design to install in its place would be a postage stamp rate design."[202] However, El Paso did not support adoption of a pure postage stamp rate design that would apply the same rate to El Paso's Texas and New Mexico zones, as to the California, Nevada, and Arizona zones, as requested by SoCal Gas/San Diego and Edison. To the contrary, El Paso presented testimony that adopting postage stamp rates in this rate case "would result in large and undue cost shifts to the Texas and New Mexico rate zones," with the result that "mitigation or other measures would probably be

[197] SoCal Gas/San Diego Rehearing at 28.

[198] Edison Rehearing at 60.

[199] *Id.* at 59.

[200] *Id.* at 60 (emphasis added by Edison).

[201] Except the Within Basin zone.

[202] Ex. EPG-224 at 5 (Prepared Answering Testimony of Mr. Derryberry).

needed to avoid excessive cost shifts."[203] Mr. Derryberry testified, "Elimination of zone rate differentials for the Texas and New Mexico zones as well – that is, establishing postage stamp rates on a system-wide basis as Mr. O'Loughlin proposes – would have an immediate and pronounced effect on rates to shippers in those two zones, with only limited benefits for the remainder of the system. . . . If postage stamp rates were made effective now, it could be necessary at a minimum to consider mitigation or other measures for the Texas and New Mexico zones to avoid the possibility of undue rate impact on shippers to [those] zones."[204] Similarly, El Paso's witness Mr. Sullivan emphasized the need to mitigate costs shifts when changing to postage stamp rates, stating "adjustments in rate design should be made gradually. In short, while distance of haul should be de-emphasized as a cost factor on the [El Paso] system, a switch to a postage stamp rate design is not appropriate at this time."[205]

121. Thus, El Paso did not support, even as an alternative to its primary rate design proposal, moving immediately to a postage stamp rate design in which shippers in the Texas and New Mexico rate zones would pay the same rates as shippers in the California, Nevada, and Arizona rate zones. In fact, the testimony of El Paso's witnesses indicates that such a rate design would cause unjust and unreasonable cost shifts, absent mitigation measures, which El Paso never specified. Moreover, as discussed previously, El Paso has not sought rehearing of our decision to reject its zone equilibration proposal, and not adopt any alternative postage stamp rate proposal. In these circumstances, SoCal Gas/San Diego and Edison must proceed under NGA section 5 in order to require El Paso to shift to a postage stamp rate design, and they cannot avoid satisfying their section 5 burden of proof by claiming El Paso made such a proposal under NGA section 4. We consider their section 5 contentions in the next section.

122. The Commission also denies Edison and SoCal Gas/San Diego's request for rehearing of our rejection of El Paso's zone equilibration proposal. The Presiding Judge's initial decision contains a detailed explanation of why he found El Paso had not satisfied its NGA section 4 burden to show that its zone equilibration proposal was just and reasonable,[206] and Opinion No. 528 includes a full discussion of the Commission's reasons for denying El Paso's exceptions to that holding. Edison and SoCal Gas raise no new arguments on this issue that were not fully addressed by the Presiding Judge and

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[203] *Id*. at 2.

[204] *Id*. at 22.

[205] Ex. EPG-175 at 26-28.

[206] Initial Decision, 139 FERC ¶ 61,020 at PP 178-181.

Opinion No 528. Moreover, at the hearing, Edison and SoCal Gas/San Diego advocated, under NGA section 5, for postage-stamp rates and argued that El Paso's zone-of-delivery rate proposal, which included the equilibration of rates, was not just and reasonable. They had a full opportunity to take a different position or to bolster El Paso's case-in-chief. However, their belated efforts to advocate a different position and/or bolster El Paso's case-in-chief fail to comply with Commission regulations regarding administrative hearings[207] and are therefore rejected.

g. Postage-Stamp Methodology

Requests for Rehearing

123. Edison submits that under NGA section 5, El Paso's zone-of-delivery methodology is unjust and unreasonable and that postage-stamp rates are just and reasonable.[208] Edison submits that closer examination of the record and substantive evaluation of record evidence along with consideration for Commission policy and precedent, demonstrate that postage-stamp rates would be just and reasonable for El Paso.[209] In particular, Edison argues that the Commission erred by failing to consider how the factors that justify postage-stamp rates in its precedents apply to El Paso and by failing to recognize that operational, structural and economic changes on the El Paso system over the last half-century have rendered El Paso's historical zone-of-delivery rate design unjust and unreasonable.[210] Finally, Edison states that it is difficult to understand how both postage-stamp rates and distance-based rates could both be just and reasonable.[211]

124. SoCal Gas/San Diego contend that in the *Texas Gas* Fuel Complaint Case the Commission "conclusively determined that distance of haul cannot be reliably established on the El Paso system."[212] SoCal Gas/San Diego also contend that in *Texas Gas*, the

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[207] 18 C.F.R. § 154.301(c).

[208] Edison Rehearing at 24, 38.

[209] *Id.* at 4, 24-36.

[210] *Id.* at 4.

[211] *Id.* at 37.

[212] SoCal Gas/San Diego Rehearing at 15-16 (citing *Texas Gas Service Co. 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,*

(continued...)

Commission identified the offsetting factors that would be necessary to make a finding supporting a fuel usage that may be attributable to distance of haul: the reticulated and integrated nature of the system, receipt of natural gas on both ends of the system, the significant use of displacement, existence of null points, different characteristics of specific facilities, differing hourly takes, and large terminal loads.[213]

Commission Determination

125. Edison argues that a closer examination of the record and Commission policy would demonstrate that postage-stamp rates would be appropriate for El Paso, especially given the operational, structural and economic changes on El Paso's system over the last 50 years. First, as stated in Opinion No. 528, Edison (and SoCal Gas/San Diego) did not meet 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.[214] Second, the NGA gives the pipeline the primary initiative, through a NGA section 4 filing, to propose its rates, terms, and conditions of service.[215] 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.[216] Thus, there was no need for the Commission in Opinion No. 528 to more fully examine the record or Commission policy in support of postage-stamp rates for El Paso.

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143 FERC ¶ 61,200 (2013) (collectively, *Texas Gas* or Fuel Complaint Case)).

[213] SoCal Gas/San Diego Rehearing at 15-16 (citing *Texas Gas*, 141 FERC ¶ 61,130 at P 51).

[214] Opinion No. 528, 145 FERC ¶ 61,040 at P 260.

[215] *Id.* (citing *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332, 340-41 (1956) (*Mobile*) (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 992 at 1002 (stating NGA grants the "primary initiative for rate-setting to the pipeline")).

[216] *Id.* (citing *Western Resources*, 9 F.3d 1568, 1578).

126. Edison states that it is difficult to understand how both postage-stamp and distance-based rates can both be just and reasonable. This is not a new dilemma; the courts have addressed it on numerous occasions. For example, in the *Permian Basin Area Rate Cases,* the court recognized that there is no single just and reasonable rate, but instead that various rates may be just and reasonable.[217] Further, in *Southeastern Michigan Gas Co. and Michigan Gas Co. v. FERC,* the court noted that on both a theoretical and practical basis, it is perfectly possible for both cross-subsidization and system-wide benefits to exist on the same facts.[218]

127. In any event, the Commission has not found that a postage stamp rate design would be just and reasonable for El Paso's system. We have simply found that it is not necessary for us to reach that issue in this case, because El Paso's existing zone of delivery rate design, including its contract path method of allocating mileage-based rates, is just and reasonable and therefore there is no basis to consider alternative rate designs under NGA section 5. Moreover, as described above, while the Texas zone rate continues to be the lowest of El Paso's five state rate zones, that rate zone is already incurring the greatest rate increase of any of these zones. This reduces the distance sensitivity of El Paso's rates, consistent with El Paso's testimony that developments on its system have reduced the variation in cost incurrence based on distance. However, imposing postage stamp rates at this time would cause an even greater increase in rates for the Texas and New Mexico zones, raising serious concerns about the justness and reasonableness of adopting postage stamp rates at this time.

128. SoCal Gas/San Diego claim that in *Texas Gas* the Commission "conclusively determined that distance of haul cannot be reliably established on the El Paso system." In the *Texas Gas* Fuel Complaint Case, Texas Gas Service and others argued, under NGA section 5, that El Paso's existing postage-stamp ***fuel rate*** was no longer just and reasonable and that the fuel cost for hauling natural gas to California and Arizona was higher than to Texas and New Mexico. The Commission upheld the Presiding Judge's finding that Texas Gas Service and its supporters failed to carry their NGA section 5 burden of proof, by a preponderance of evidence, that distance was the predominant driver of fuel usage that the impact of distance of haul on fuel costs is so substantial that

[217] *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), *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).

[218] *Southeastern Michigan Gas Co. and Michigan Gas Co. v. FERC*, 133 F.3d 34, 41 (D.C. Cir. 1998).

El Paso's existing, postage-stamp fuel rate is unjust and unreasonable.[219] In this case, variable fuel costs are not at issue,[220] and, as discussed above, the Commission has found that El Paso has shown under NGA section 4 that its existing contract-path method of allocating mileage-based fixed costs is just and reasonable. Further, SoCal Gas/San Diego imply that the offsetting factors identified in *Texas Gas* are the only factors to consider. They are not and *Texas Gas* does not imply that they are.[221]

2. Discount Adjustments

Opinion No. 528

129. As noted in Opinion No. 528, El Paso proposed a discount adjustment to the billing determinants it proposed to use both to allocate its cost of service among services and rate zones and to design its per unit rates.[222] 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. Several parties opposed El Paso's proposal, asserting that El Paso should be required to share in the costs of its discounted and unsubscribed capacity. In Opinion No. 528, the Commission affirmed the Presiding Judge's finding that El Paso had the burden of proof under NGA section 4 to establish that its method for addressing discounted and unsubscribed capacity was adequately supported to maintain just and reasonable rates.[223] The Commission also affirmed the finding in the Initial Decision that El Paso is entitled to a full discount adjustment so as to give it an opportunity to recover costs related to unsubscribed capacity.

130. The Commission noted that, under the *Policy for Selective Discounting By Natural Gas Pipelines (Selective Discounting Policy)*,[224] a discount adjustment is appropriate

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[219] *Texas Gas,* 141 FERC ¶ 61,130 at PP 45-52.

[220] *2011 Rate Case Suspension Order*, 133 FERC ¶ 61,104 at P 14.

[221] *Texas Gas,* 141 FERC ¶ 61,130 at P 50 ("[Texas Gas Service] and it supporters also failed to account for the many factors that offset whatever fuel usage may be attributable to distance of haul" and "[t]hese other factors ***include***….") (emphasis added).

[222] Opinion No. 528, 145 FERC ¶ 61,040 at P 359.

[223] *Id.* P 389.

[224] *Selective Discounting Policy*, 111 FERC ¶ 61,309, *reh'g denied*, *Selective Discounting Policy Rehearing Order*, 113 FERC ¶ 61,173.

where a discount is provided to meet competition, in order to permit the pipeline the opportunity to recover costs of its facilities. The Commission stated that 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. The Commission found that the record unequivocally demonstrated that El Paso's discounted agreements and unsubscribed capacity were attributable to competition and that no participant argued otherwise.[225] The Commission thus agreed with the Presiding Judge that El Paso had satisfied the burden of proof ordinarily required to show that a full discount adjustment to rate design billing determinants is just and reasonable.

131. The Commission also addressed claims by certain parties that, while El Paso's discounted agreements may have been offered in response to competition, a full discount adjustment would result in exorbitant rates that would fall disproportionately on captive customers. Those customers who take service in El Paso's East of California rate zones argued that most of the discounts provided by El Paso were to its customers in its California rate zone, and thus the use of discounted billing determinants to allocate costs and design rates had the effect of shifting those costs to East of California rate shippers. Those parties also argued that the *Selective Discounting Policy Rehearing Order* imposed limits on discount adjustments to protect captive customers from excessive and unjust rate increases and allows the Commission to adopt measures to protect customers where a discount adjustment would result in undue hardship for some shippers. They claimed that such circumstances exist here because allowing a full discount adjustment would have a disproportionate rate impact on captive customers, and thus that the Commission should adopt mitigating measures to ensure just and reasonable results.

132. The Commission rejected these claims. Noting that 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 its customers, the Commission agreed with the Presiding Judge that the parties in the proceeding had not made such a showing. The Commission agreed with the Presiding Judge's findings that mere claims that El Paso's rates had gone up over the last few rate cases, and that discounts were mainly responsible for those increases, were speculative and unsupported, and thus not enough to show that the resulting rates were unjust and unreasonable.[226] The Commission also found that El Paso had provided evidence of offsets to those rate

[225] Opinion No. 528, 145 FERC ¶ 61,040 at P 390.

[226] *Id.* PP 391-393; Initial Decision, 139 FERC ¶ 63,020 at PP 271-272 (citing *Selective Discount Policy,* 111 FERC ¶ 61,309 at P 56; 113 FERC ¶ 61,173 at P 115).

increases that the protesting parties failed to consider,[227] and that El Paso had aggressively remarketed its unsubscribed capacity.

133. Based on these findings, the Commission concluded that El Paso had met its burden to show that the discounts it offered were necessary to meet competition and that customers had failed to support claims the resulting rates would be too high. The Commission noted that if El Paso had not aggressively marketed its unsubscribed capacity and offered discounts to meet competition, then the discounted agreements and their corresponding throughput and revenue would not exist, and thus the resulting rates could be even higher than proposed because there would be less opportunity for El Paso to seek to recover its costs. Accordingly, the Commission found that El Paso had demonstrated that it had offered discounts to meet competition and had made reasonable efforts to remarket its unsubscribed capacity, and thus that opposing customers had not supported their claim that El Paso had not met its burden.

134. In response to the customers claiming that allowing El Paso a full discount adjustment would disproportionally impose exorbitant rates on captive (East of California) shippers, the Commission stated that its rejection of El Paso's proposal to allocate costs among its rate zones based on discount-adjusted billing determinants effectively mitigates the effect of which the customers complained. The Commission found that requiring El Paso to use unadjusted billing determinants to allocate fixed costs among rate zones would address the shippers' concerns with respect to the improper reallocation of costs as a result of the discount adjustment.[228]

<u>Request for Rehearing</u>

135. ACC/Southwest Gas contend that Opinion No. 528 improperly restricts the Commission's ability to require a pipeline to share in the costs of discounting, and thereby limits the Commission's constitutional authority to remedy undue discrimination and unjust and unreasonable rates under NGA sections 4 and 5. ACC/Southwest Gas further argue that Opinion No. 528 violates longstanding Commission policy.

136. ACC/Southwest Gas assert that El Paso's shareholders should share market losses with its captive shippers.[229] According to ACC/Southwest Gas, Opinion No. 528 held that the Commission lacks authority under the NGA to place a portion of the market risk

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[227] Opinion No. 528, 145 FERC ¶ 61,040 at P 391.

[228] *Id.* PP 392, 395.

[229] ACC/Southwest Gas Rehearing at 2.

associated with unsubscribed and discounted capacity on El Paso. ACC/Southwest Gas urge the Commission to overturn this alleged holding, or at a minimum, limit it to the facts of this case. ACC/Southwest Gas state that by incorrectly construing the constitutional minimum rate the Commission unreasonably limits its authority under the NGA to balance investor and consumer interests, and, by definition, to determine just and reasonable rates.[230]

137. ACC/Southwest Gas concede that they "agree with the Commission's finding that 'the Commission must balance the customer interest in protection from high rates against the investor interest in rates that produce a reasonable return.'"[231] ACC/Southwest Gas argue that in practice, however, the Commission erroneously granted "a minimum constitutional entitlement of the pipeline to full cost recovery at design billing determinant levels."[232] ACC/Southwest Gas further conclude that because El Paso presented a constitutional objection to ACC/Southwest Gas' risk sharing proposal the Commission was required to make a *Hope* end-results determination of the kind discussed in *Jersey Central*.[233]

138. ACC/Southwest Gas claim that Opinion No. 528 never "specifically discuss[es] the constitutional questions raised."[234] ACC/Southwest Gas note, however, that the Initial Decision did discuss these constitutional questions, ACC/Southwest Gas did object to the constitutional discussion in its brief on exceptions, and Opinion No. 528 expressly stated that any exceptions that the Opinion fails to discuss were denied. ACC/Southwest Gas claim that Opinion No. 528 effectively affirmed the Initial Decision's faulty constitutional rationale by rejecting their exceptions concerning the constitutional questions, and, doing so, misinterpreting and severely limiting the Commission's

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[230] ACC/Southwest Gas define the constitutional minimum rate as being "the 'lowest reasonable rate' is one which is not confiscatory in the constitutional sense" and "[r]ates which enable the company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risks assumed certainly cannot be condemned as invalid." Rehearing at 11 (citing *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575, 585 (1942) and *Hope*, 320 U.S. 591 at 602).

[231] ACC/Southwest Gas Rehearing at 11 (quoting Opinion No. 528, 145 FERC ¶ 61,040 at P 393).

[232] ACC/Southwest Gas Rehearing at 11.

[233] *Id.* at 12 (citing *Jersey Central*, 810 F.2d 1168 at 1176-78).

[234] *Id.* at 21.

statutory power under the NGA to remedy undue discrimination and unjust and unreasonable rates.[235] ACC/Southwest Gas request rehearing and further request that the Commission find that it has constitutional and statutory power to approve rates and rate-making methods that place some risk of cost under-recovery on interstate natural gas pipelines.[236]

139. Further, ACC/Southwest Gas argue that the Commission deviated from existing policy. ACC/Southwest Gas emphasize that the Commission expects pipelines to "bear some market risk,"[237] and that the Commission's *Selective Discounting Policy Rehearing Order*[238] permits shippers the opportunity to prove that their case is one that does not warrant the routine discounting adjustment.[239] They argue that, in the course of acknowledging the *Selective Discounting Policy,* Opinion No. 528 narrows its utility[240] because Opinion No. 528 allegedly finds that a pipeline is entitled to full cost recovery and that challenges are limited to whether a pipeline provided a competitive justification.[241]

140. ACC/Southwest Gas also acknowledge that in Opinion No. 528 the Commission "accurately states that its decision on zonal cost allocation will mitigate the discriminatory shifting of discount-related fixed costs from the California rate to El Paso's other rate zones" and thus "largely protects maximum recourse rate shippers in Arizona, New Mexico, and Texas."[242] ACC/Southwest Gas do not challenge the end results reached by the Commission because of its zonal cost allocation. ACC/Southwest Gas further state that if Opinion No. 528 had explained that risk sharing was not needed to protect East of California shippers because the zonal cost allocation holding achieved a comparable result in terms of protection from cost shifting and undue discrimination then

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[235] *Id.* at 22.

[236] *Id.*

[237] *Id.* at 23.

[238] *Selective Discounting Policy Rehearing Order*, 113 FERC ¶ 61,173.

[239] ACC/Southwest Gas Rehearing at 25.

[240] ACC/Southwest Gas Rehearing at 27.

[241] *Id.* at 28 (citing Opinion No. 528, 145 FERC ¶ 61,040 at P 389).

[242] *Id.* at 27.

the order would have been "understandable." They claim that the Commission provided no such explanation, however, and thus that Opinion No. 528 limits the ability of a shipper to challenge a pipeline's discount adjustment to those situations where a pipeline provides the discount without competitive justification.[243]

Commission Determination

141. We deny rehearing on this issue, and also provide clarification as discussed more fully below. As noted, ACC/Southwest Gas interpret Opinion No. 528 as holding that pipelines have a right to recover 100 percent of their costs, and that the Commission lacks the authority under the NGA to place the pipeline at risk for costs associated with unsubscribed and discounted capacity. ACC/Southwest Gas also challenge the alleged failure of Opinion No. 528 to limit the rejection of risk sharing to the facts of this case. As discussed below, Opinion No. 528 did not make the changes to Commission policy ACC/Southwest Gas contend it did but followed and applied the Commission's *Selective Discounting Policy*. On rehearing, we continue to find that the circumstances of this case do not justify denying El Paso the ability to use a full discount adjustment in designing its rates, despite our grant of rehearing above on the zonal cost allocation issue.

142. The Commission did not intend in Opinion No. 528 to alter in any manner its policy concerning discount adjustments, as set forth in the *Selective Discounting Policy* Statement or other Commission orders. In the *Selective Discounting Policy* orders, the Commission found that adjusting a pipeline's rate design volumes to reflect its discounts is generally appropriate where the discounts are provided to meet competition. The Commission explained that discounts benefit all customers by allowing the pipeline to maximize throughput and thus spread fixed costs over a greater volume of sales. Further, as the Commission has explained, selective discounting protects captive customers from rate increases that would otherwise occur if pipelines lost volumes through the inability to respond to competition. As we noted in Opinion No. 528, under the policy, when a pipeline files a rate case after granting a discount, the pipeline is permitted to demonstrate that the discounts given in the test period were made to meet competition.[244] If the pipeline makes such a showing, the Commission generally permits the pipeline to design its rates so that it will recover 100 percent of its cost of service if competition requires it to offer the same level of discounts as during the test period.[245] In this manner, the

[243] *Id.* at 28.

[244] Opinion No. 528, 145 FERC ¶ 61,040 at P 393.

[245] *Id.*

Commission provides a pipeline that is required to offer discounts to meet competition an opportunity to propose a rate design that will recover 100 percent of its costs.

143. While the Commission has consistently approved discount adjustments in section 4 rate cases, nothing in the *Selective Discounting Policy* orders establishes a rule or mandates that pipelines have a right to a full discount adjustment in all instances. As we also stated in the *Selective Discounting Policy Rehearing* Order, the Commission will consider the impact of any discount adjustment on captive customers in specific proceedings.[246] In addition, the Commission stated that it may not permit a full discount adjustment in situations where that would lead to an inequitable result.[247]

> 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.[248]

Accordingly, the Commission has held that it may adopt measures to protect captive customers where a discount adjustment would impose an undue hardship on customers, and that it could consider mitigating measures on a case-by-case basis.[249] Nothing in Opinion No. 528 or this order in any manner alters the rights and protections for captive customers afforded under the NGA or the *Selective Discounting Policy*.

144. However, the Commission continues to find that this case does not present circumstances warranting disallowance of a full discount adjustment, despite our decision above to grant rehearing of Opinion No. 528's rejection of El Paso's proposal to use discount-adjusted billing determinants to allocate costs among rate zones. In order for a

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[246] *Selective Discounting Policy Rehearing Order*, 113 FERC ¶ 61,173 at P 37.

[247] *Id.* P 55.

[248] *Id.* P 22.

[249] *See, e.g.*, *id.* P 62.

pipeline to reduce its billing determinants to reflect discounting, the Commission requires the pipeline to show that competition during the test period required it to give discounts in order to attract or retain load.[250] In this case, there is no dispute that El Paso has satisfied that burden. In fact, the Presiding Judge found that "the record is overwhelming/unequivocal" that El Paso provided its discounts in order to meet competition.[251] 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.

145. With our decision above that El Paso may use discount-adjusted volumes to allocate costs among rate zones, El Paso's FT-1 rates for service in the Arizona rate zone where Southwest and the Arizona LDCs take their natural gas will increase by about 11 percent over the rates approved in El Paso's last rate case. With the exception of the Texas rate zone discussed previously, no rate zone will experience a rate increase in excess of about 16 percent. While the Commission recognizes that these rate increases are substantial, they are not so excessive as to justify the extraordinary remedy of designing the pipeline's rates so that it will not be able to recover its cost of service if competitive conditions remain the same as during the test period.

146. In two orders in 1995, the Commission stated that a pipeline cannot expect to be able to recover all the costs of its unsubscribed capacity from its remaining customers.[252] However, those two cases involved significantly greater potential cost shifts to captive customers than are at issue here, resulting from levels of completely unsubscribed capacity as well as discounting. In both cases, the pipelines anticipated that they would have large amounts of unsubscribed capacity, because large customers had given notice that they would terminate their firm contracts.[253] In both cases, the pipelines anticipated that the termination of those firm contracts would require rate increases substantially in excess of those at issue here. For example, *Natural* indicated that it would have to

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[250] *Panhandle I*, Opinion No. 404, 74 FERC ¶ 61,109 at 61,404. *Williston Basin Interstate Pipeline Co.*, 84 FERC ¶ 61,081 at 61,401 (1998). *Iroquois*, 84 FERC ¶ 61,086 at 61,477.

[251] Initial Decision, 139 FERC ¶ 63,020 at P 254.

[252] *El Paso Natural Gas Co.*, 72 FERC ¶ 61,083, at 61,441 (1995) (*El Paso*) (1995 Suspension Order). *Natural Gas Pipeline Company of America*, 73 FERC ¶ 61,050 (1995) (*Natural*).

[253] *El Paso*, 72 FERC at 61,439; *Natural*, 73 FERC at 61,128.

increase its rates by 50 to 60 percent.[254] Moreover, the Commission was concerned that neither pipeline had made a sufficient effort to remarket its unsubscribed capacity but was simply seeking to shift the costs of that capacity to its remaining customers.[255] For example, in *Natural*, the Commission stated, "We believe it is important for Natural to recoup some of its costs by marketing its capacity. There is nothing in Natural's filing to indicate it has pursued such an approach or done anything to mitigate the impact of the costs of the unsubscribed capacity."[256]

147. This case does not involve similar circumstances. The Presiding Judge found that El Paso has aggressively marketed its capacity. As a result, he found that nearly all of El Paso's capacity was subscribed during the test period in this proceeding—though much of it was subscribed under sculpted long-term firm contracts, on a short-term basis, or at significantly discounted rates.[257] The Presiding Judge accordingly found that only two to five percent of El Paso's total sustainable capacity can legitimately be characterized as "unsubscribed."[258] With a full discount adjustment to reflect the discounts El Paso gave in order to aggressively market its capacity, El Paso's rates will generally increase by 16 percent or less, well below the 50 to 60 percent rate increase at issue in *Natural*. No party alleges that El Paso's current difficulties in marketing its capacity are the result of any imprudence on its part. If the Commission were to require El Paso to design its rates so that it would not recover 100 percent of its cost of service if competition requires El Paso to continue providing the same level of discounts as during the test period, the Commission would have to seriously consider finding El Paso more risky than the proxy group companies and therefore award a return on equity at the top of the zone of reasonableness, instead of at the median.[259]

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[254] *Natural*, 73 FERC at 61,129.

[255] *El Paso*, 72 FERC at 61,439; *Natural*, 73 FERC at 61,129.

[256] *Natural*, 73 FERC at 61,129.

[257] Initial Decision, 139 FERC ¶ 63,020 at P 269 (citing Ex. EPG-404 at 66-77, Ex. SWG-14 at 7, and Ex. UNS-1 at 13).

[258] *Id.* (citing Ex. EPG-404 at 42).

[259] *See Portland Natural Gas Transmission System*, Opinion No. 524-A, 150 FERC ¶ 61,107, at PP 192-196 (2015) (affirming an ROE at the top of the range of reasonableness based in part on the fact that the pipeline's at-risk condition required that its rate be designed so that it would not recover its full cost of service if competitive conditions during the test period continued).

148. For these reasons, we affirm the Presiding Judge's decision that El Paso should be permitted to design its rates using a full discount adjustment and that the shippers' various risk sharing proposals should be rejected.

3. **Variable Cost Allocation**

Background

149. In its September 30, 2010 filing, El Paso classified all of its variable costs as mileage-based and proposed to continue to recover these costs through its zone-of-delivery usage charges. El Paso stated that its zone-differentiated usage charge helps produce an overall end result for its combined reservation, usage and fuel rates that is reasonable. El Paso further stated that it has attempted to strike a reasonable balance in these rates that reflects distance by a modest, but appropriate, degree.[260]

150. Consistent with its overall support for a postage-stamp rate design, Edison argued that no costs should be based on distance.[261] Edison further argued that since El Paso's compressor fuel costs are allocated on a postage-stamp basis, its non-fuel compressor costs should be treated on the same basis as El Paso's fuel costs.

151. SoCal Gas/San Diego argued 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.[262] SoCal Gas/San Diego argued that the costs associated with compressor stations, whose primary purpose is to bring pooled supplies of natural gas up to operating pressures, should not be considered mileage-related. They also argued 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.

152. In the Initial Decision, the Presiding Judge adopted the SoCal Gas/San Diego view to treat compressor station costs as non-mileage-related.[263] Opinion No. 528 affirmed the Presiding Judge's finding and classified El Paso's storage compressor station cost as non-

[260] Opinion No. 528, 145 FERC ¶ 61,040 at P 331 (citing El Paso Initial Br. at 89).

[261] Edison Initial Br. at 56-58.

[262] Opinion No. 528, 145 FERC ¶ 61,040 at P 333 (citing SoCal Gas/San Diego Initial Br. at 31-34).

[263] *See id.* P 334; Initial Decision, 139 FERC ¶ 63,020 at P 188.

mileage relates, including costs for those compressor stations whose purpose is to increase the pressure of pooled natural gas supplies to the pressure level of mainline facilities.[264] And based on SoCal Gas/San Diego's detailed analysis,[265] the Commission found that El Paso's proposal to continue to classify costs associated with these compressor stations as mileage-based was no longer just and reasonable. The Commission further found that SoCal Gas/San Diego's proposal to classify those costs as non-mileage-based is just and reasonable.

153. In response to Edison's Brief on Exceptions, Opinion No. 528 noted that because no party presented evidence as to the appropriate classification of the variable costs for the remaining compressor stations, the Commission was required to accept El Paso's classification of those costs as mileage-based.[266]

Request for Rehearing

154. Edison argues that if El Paso is not required to adopt postage-stamp reservation rates, it should be required to calculate postage-stamp usage rates to reflect non-mileaged treatment of all its non-fuel variable costs.[267] Edison further argues that the record supported the classification of all of El Paso's variable costs as non-mileage based.[268]

Commission Determination

155. Edison offers no new arguments on rehearing. The evidence that Edison cites refers to parties' "back-up" proposals, not their cases-in-chief. Accordingly, as described above, there is not sufficient evidence supporting Edison's position. Further, as noted in Opinion No. 528, 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 still has not met that burden.[269] Accordingly, its request for rehearing of the treatment of certain variable costs is denied.

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[264] Opinion No. 528, 145 FERC ¶ 61,040 at P 338.

[265] *Id.* (citing Ex. SCG-11 at 7-10; Ex. SCG-12; Ex. SCG-13).

[266] *Id.* P 339.

[267] Edison Rehearing at 5, 64.

[268] *Id.* at 61-63 (citing Ex. SCE-1 at 35, SCE-8, Tr. 1478-1479 (Derryberry)).

[269] Opinion No. 528, 145 FERC ¶ 61,040 at P 339.

4. Rate Design for Premium Rate Schedules -- FT-H and IHSW

a. Rate Schedule FT-H Premium Factors

156. With respect to El Paso's proposed rates for Rate Schedule FTH hourly firm transportation service, UNS/Tucson Electric request rehearing of the Commission's determinations that El Paso may (1) apply weighted premium factors to the full distance of the contract path and (2) use weighted premium factors to allocate non-mileage costs. For the reasons discussed below, the Commission denies rehearing.

Background

157. El Paso provides four premium FTH services that allow shippers to exceed their respective uniform or ratable hourly entitlement by specified percentages and hours per day.[270] According to El Paso, it must reserve capacity and expend additional administrative and general (A&G) costs to provide FTH services.[271] In Opinion No. 528, the Commission affirmed El Paso's proposal to assign these A&G costs to the FTH services (and away from other services) evenly between the deliverability and capacity components.[272] The Commission accepted El Paso's proposal to incorporate a 100 percent premium capacity factor and a deliverability factor which would increase with hourly usage and degree of variability.[273] The deliverability and capacity factors are averaged for each rate schedule to develop the weighted premium factor.[274]

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[270] *Id.* P 279 ("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.").

[271] *Id.* PP 279-280 (citing Ex. EPG-107 at 20, 30-31, EPG-394 at 36).

[272] *Equitable Gas Co.*, 36 FERC ¶ 61,147 (1986) (*Equitable*); *see also* Initial Decision, 139 FERC ¶ 63,020 at PP 243-244.

[273] Opinion No. 528, 145 FERC ¶ 61,040 at PP 279-281 ("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").

[274] *Id.* PP 279-280.

158. Several parties, including UNS and Tucson Electric, argued on exceptions that the weighted premium factor should only apply to 300 miles of the haul rather than to the full distance as El Paso proposed.[275] In Opinion No. 528, the Commission affirmed the Presiding Judge's finding that using full miles hauled in designing the cost allocation methodology was consistent with the contract-path methodology and had fewer disadvantages than the other options available. Further, the Commission found that limiting weighted premium factors to an average of miles would result in cross-subsidization between the premium services.[276]

159. The Commission, however, found 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. The Commission rejected arguments that these costs should not be included because El Paso did not provide evidence of the level of costs associated with such usage. The Commission reasoned that the overall methodology that the FTH rates were based on did not require specificity and thus individual parts such as the non-mileage costs were not required to be demonstrated with specificity.[277]

<u>Request for Rehearing</u>

160. UNS/Tucson Electric object to the Commission's finding that El Paso could use weighted premium factors based on the full distance of the contract path. They repeat their argument that weighted premium factors should not be applied to the full distance of the contract path because they do not impact the entire distance. They offer as an example that, when using the FTH-3 service, UNS is charged for the full 695 miles of the contract path while the premium services only actually impact 160 miles of the path.[278] They derive these numbers from rebuttal testimony from Mr. Mark Westhoff, El Paso's Director of Facility Planning, indicating that the impact of the FTH-3 service can be fully attenuated approximately 160 miles from the delivery point.[279]

[275] *Id.* P 283 (citing UNS/Tucson Electric Initial Br. at 26-29).

[276] *Id.* P 300.

[277] *Id.* PP 305-306.

[278] UNS Rehearing at 4-7.

[279] UNS Rehearing at 6 (citing Ex. EPG-145 at 50, Ex. EPG-316).

161. In addition, UNS/Tucson Electric object to the Commission's finding that El Paso may use weighted premium factors to allocate non-mileage costs. UNS/Tucson Electric argue that El Paso failed to provide evidence supporting the extra costs.[280]

Commission Determination

162. The Commission denies rehearing on both of UNS/Tucson Electric's issues. First, the Commission affirms its prior determination that using weighted premium factors based on the full distance of the contract path is appropriate and consistent with El Paso's contract-path methodology. Adopting UNS/Tucson Electric's method based on actual miles impacted by premium usage would undermine a key advantage of using contract-path methodology – to minimize the difficulty in determining actual miles of haul.[281] Further, the number is not arbitrary because, even if the FTH services only impact a certain number of miles of the contract path, the shipper is paying for the right to receive service for the full distance of the contract path. Thus, rehearing is denied on this point.

163. Second, the Commission affirms its prior determination that including hourly service non-mileage costs is appropriate and consistent with the overall weighted premium factor methodology. El Paso provided testimony showing that providing the premium hourly services required A&G expenses.[282] As noted in Opinion No. 528, the Commission approved an overall methodology for the FTH rates which is based on El Paso's proposed weighted premium factors. The Commission explained that it did not require specificity in approving the entire methodology, and will not require specificity for this discrete part of the methodology because to do so would require a quantification of costs that does not exist. UNS/Tucson Electric have not shown otherwise. Consequently, rehearing is denied.

b. Rate Design for Rate Schedule IHSW

164. Sempra/Golden Spread request rehearing of the Commission's decision to uphold El Paso's proposed rate design for Interruptible Hourly Swing Service (IHSW).[283] For the reasons discussed below, the request for rehearing is denied.

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[280] UNS Rehearing at 8-10.

[281] Opinion No. 528, 145 FERC ¶ 61,040 at P 222 (citing Initial Decision, 139 FERC ¶ 63,020 at P 165).

[282] Ex. EPG-107 at 19-20.

[283] Sempra/Golden Spread Rehearing at 1-2.

Background

165. El Paso offers interruptible hourly swing service under Rate Schedule IHSW for shippers that also receive FT-1, FTH or IT-1 service. Rate Schedule IHSW permits shippers to flow 160 percent of 1/24th of their daily scheduled quantities on an interruptible basis for up to 15 hours a day without incurring scheduling penalties. IHSW service is a no-notice service and a shipper is not required to make a daily or hourly nomination to use the service.

166. In 2006, when the Commission accepted El Paso's proposal to develop premium services, it noted the operational difficulties that swing services imposed on the system, including reliability concerns, the need for additional line pack with the potential for decreasing pressure, and the need to reserve additional capacity to provide swing service.[284] In addition, although the Commission deferred rate issues to hearing, it advised the Parties that "[t]he capacity that El Paso allocates to the new services has costs that may be recovered from the customers who use the services" and that "[c]osts will be allocated to reflect the demand for such services on a fully allocated basis, consistent with Commission policy."[285]

167. In Opinion No. 528, the Commission approved El Paso's proposal to derive its IHSW rate from the Rate Schedule FTH-16 rate at a 100 percent load factor. The Commission found that the 100 percent load factor FTH-16 service most closely approximates the hourly flexibility provided by IHSW service.[286] Further, Opinion No. 528 noted that the Presiding Judge found that Sempra failed to support its proposal to develop the rate for IHSW service at the marginal cost of providing supplemental IHSW service.[287] Rather, Opinion No. 528 found that, based on its *prima facie* case, El Paso's proposed IHSW rate design was just and reasonable.[288]

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[284] *El Paso Natural Gas Co.,* Order on Technical Conference, 114 FERC ¶ 61,305, at P 38 (2006) (*March 23, 2006 Order*). IHSW rates were previously established through the "black box" settlement in the 2008 Rate Case Settlement, which included limited discounts. *El Paso Natural Gas Co.,* 131 FERC ¶ 61,077, at P 5 (2010) (2008 Rate Case Settlement Order).

[285] *March 23, 2006 Order*, 114 FERC ¶ 61,305 at P 47.

[286] Opinion No. 528, 145 FERC ¶ 61,040, at P 315.

[287] *Id.* P 310.

[288] *Id.* PP 315-316.

Request for Rehearing

168. Sempra/Golden Spread argue that the Commission erred in three respects when approving the IHSW rate: (1) it provided insufficient reasoning to support its decision, (2) it approved a rate design that allows over recovery because shippers must use IHSW service in combination with other services to use El Paso's system and (3) it adopted the FTH-16 rate as a reference point for the IHSW rate despite material differences between the services.[289] These shippers claim they must first subscribe to and pay for ratable transportation rights under ratable service plans. Such rate plans include the cost to flow the scheduled quantity. They argue on rehearing that the Commission should require El Paso to revise its rates to eliminate the double recovery of costs.[290]

Commission Determination

169. The Commission denies the Sempra/Golden Spread request for rehearing. As discussed in the Initial Decision and Opinion No. 528, the Commission's policy allows interruptible transportation rates to be derived from comparable firm service.[291]

170. The Commission finds that FTH-16 service, which is a 16-hour firm service, is a better match for the IHSW service, which is a 15-hour swing service.[292] Although FTH-16 service provides one more hour in a day when a shipper can swing, this difference is roughly matched by an increase in flexibility, because a shipper using IHSW service can swing 10 percentage points more above its hourly entitlement than a shipper subscribed to the FTH-16 service. The FTH-12 service that Sempra/Golden Spread propose to use as a starting point for calculating the IHSW rate is less similar to the IHSW services than the FTH-16 service because FTH-12 provides three fewer hours in which the shipper can swing its natural gas flows.

171. The Commission affirms its findings in Opinion No. 528 that El Paso will not impermissibly over recover costs due to the requirement that IHSW service must be purchased with another service. In Opinion No. 528, the Commission found that

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[289] *Id.* P 315.

[290] Sempra/Golden Spread Rehearing at 18.

[291] Initial Decision, 139 FERC ¶ 63,020 at P 201 (citing *Elizabethtown Gas Co. v. FERC*, 10 F.3d 866, 871 (D.C. Cir. 1993); *Arkla Energy Resources, Co.*, 67 FERC ¶ 61,208, at 61,646 (1994)).

[292] Opinion No. 528, 145 FERC ¶ 61,040 at P 315.

additional charges are appropriate because IHSW service is a separate and supplemental service. That is, the service entitles a shipper to ship additional volumes of natural gas on a per hour basis above its hourly entitlement and the IHSW rate applies to those volumes. The Commission found El Paso's rate design appropriate, citing its practice to approve interruptible rates based on firm equivalents.[293]

172. Shippers' objections to the bundled nature of the IHSW rates appear to boil down to an objection to the fact that, while IHSW service allows a shipper to swing (to take additional delivery in a given hour over its hourly entitlement), the service does not include its own transportation right and the IHSW service does not entitle the shipper to a right to take additional natural gas for the day in which service is taken. Because IHSW service is a premium, flexible service, it is appropriate to expect a shipper to pay a fully allocated rate based on the weighted premium factors.

173. On rehearing of El Paso's 2006 rate case proceeding, where the Commission first expressed its approval for the premium service package, the Commission defended the "bundled" nature of the services, finding that the El Paso system lacked storage and therefore needed to rely on "horizontal" storage to support the new services.[294] These facts continue to support the Commission's determination to accept El Paso's proposal to price the premium services as a fully allocated rate based on the premium factors.

174. In the March 23, 2006 Order, the Commission considered the need for additional storage, the additional capacity needed to accommodate flexible takes, and the effect on service quality.[295] On the basis of those factors, the Commission declines to order an adjustment to account for the fact that the IHSW service lacks the right to transport additional ratable natural gas. The Commission's statements in the 2005 rate proceeding affirmed the bundled nature of the services and found that customers should pay for the additional capacity needed to support those services on a fully allocated basis. Shippers purchasing IHSW service use additional capacity to move an additional volume of natural gas on an hourly basis over and above their Rate Schedule FT or IT ratable delivery or their hourly entitlements under Rate Schedules FTH. The Commission previously noted that the operational adjustments needed to support flexible deliveries utilized additional system resources and could place a strain on the system, justifying fully allocated rates for the new services. We do not agree with the positions of the parties on rehearing that

[293] *Id.*

[294] September 5 Order, 124 FERC ¶ 61,227 at P 109.

[295] March 23, 2006 Order, 114 FERC ¶ 61,305 at P 47.

these factors are insignificant or are offset by the inability to obtain and seek throughput for an additional volume of natural gas.

175. IHSW service permits a shipper to increase its hourly take of natural gas for up to 15 hours, without notice and without prior scheduling. That flexibility is reflected in the price of the service. Thus, the additional cost of the service is justified by the premium service features and the additional system resources needed to support premium services. No shipper is required to take the service, and we disagree that the service should bear only a nominal rate, in light of the operational strain that unrestrained flexibility may cause on the system.[296] Though the service may not include the capability to nominate an additional volume of natural gas for the day, that fact is mitigated by the additional hourly flexibility provided.

176. El Paso has avoided double recovery of costs, insofar as it has proposed a revenue credit for A&G costs supporting the service.[297] In addition, the structure of El Paso's flexible services portfolio permits shippers to minimize their exposure to paying for unused reservations.[298]

177. While a shipper must receive service under Rate Schedule FT-1, FTH or IT-1 in order to obtain IHSW service and the accompanying interruptible swing rights, the combined costs may be lower than FTH-16 rates at the 100 percent load factor. This is because a shipper using FTH-16 service must pay the FTH-16 rates for all natural gas shipped regardless of whether the right to swing is used. By contrast, a shipper using IHSW service is only charged the swing rate for natural gas shipped using the swing services. Thus, an interruptible shipper's daily rates can be comparable to a FTH-16 shipper's daily rates where the interruptible shipper only uses the swing right for a few hours on a daily basis.[299] In such cases, shippers are not paying for shipping twice.

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[296] *See id.* P 38.

[297] *See* Opinion No. 528, 145 FERC ¶ 61,040 at P 316.

[298] *March 23, 2006 Order*, 114 FERC ¶ 61,305 at PP 30-32.

[299] For example, a shipper shipping 100 Dth in a day under the currently-effective rates for Arizona, Rate Schedule IT-1 that uses IHSW service to ship 10 Dth above its ratable share would pay total daily rates of $41.23, while a shipper using a FTH-16 TSA at the 100 percent load factor for similar service would pay a total daily rate of $42.60. Part II: Stmt. of Rates, Section 1.9 - Interruptible and PAL Rates, 4.0.0; Rate Schedule IT-1; Part III: Rate Schedules, Section 3 - Rate Schedule FT-H, 9.0.0; Rate Schedule IHSW.

While rates may also go above the FTH-16 rates at the 100 percent load factor the shipper has some control over this amount since it can opt to use the IHSW more or less often.

178. For the above reasons, the Commission affirms its approval of El Paso's use of FTH-16 rates to set IHSW rates. For the reasons discussed herein, we deny rehearing on this issue.

D. Article 11.2

179. The 1996 Settlement established a rate cap for certain shippers. Specifically, 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 shippers terminate their transportation service agreements (TSA).[300] Article 11.2(b) provided that even if eligible shippers entered into new service

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[300] 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.
>
> (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

(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 Article 11.2 rate level (so long as the settlement continues to apply to a given shipper).

180. The operation of Article 11.2 has been a highly contentious issue in numerous El Paso proceedings for more than a decade. 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.[301] This finding is consistent with a series of orders over the last decade.[302]

181. For instance, 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.[303] 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.[304] In the

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> 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).

[301] Opinion No. 517, 139 FERC ¶ 61,095 at PP 232-255; *Mobile*, 350 U.S. 332; *Federal Power Comm'n v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956) (*Sierra*).

[302] *E.g.*, Opinion No. 517, 139 FERC ¶ 61,095; September 5 Order, 124 FERC ¶ 61,227 at P 41 (citing *ACC*, 397 F.3d 952); March 20 Order, 114 FERC ¶ 61,290 at PP 36-37; Capacity Allocation Rehearing, 104 FERC ¶ 61,045, at PP 92-93 (2003); Capacity Allocation Complaint Order, 99 FERC ¶ 61,244, 62,005.

[303] *El Paso Natural Gas Co.*, 104 FERC ¶ 61,045, at PP 92-93, (2003) (Capacity Allocation Rehearing).

[304] March 20 Order, 114 FERC ¶ 61,290 at PP 36-37.

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.[305]

182. 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:

> In 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*.[306]

183. 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. In Opinion No. 517, the Commission (a) affirmed the Presiding Judge's determinations that the *Mobile-Sierra* standard applies and that Article 11.2 should not be abrogated under the *Mobile-Sierra* public interest standard; (b) 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; (c) found that El Paso had satisfied the Article 11.2(b) requirements; and (d) 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.[307]

184. 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

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[305] *Id.* P 34 (citing *Capacity Allocation Complaint Order*, 99 FERC ¶ 61,244, 62,005).

[306] September 5 Order, 124 FERC ¶ 61,227 at P 41 (citing *ACC*, 397 F.3d 952).

[307] Opinion No. 517, 139 FERC ¶ 61,095 at PP 232-235, 289-300, 322-330, 331-332.

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 purported 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 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."[308]

185. In Opinion No. 528, the Commission found that (a) Article 11.2 remains in effect consistent with the public interest, (b) El Paso may not reallocate shortfalls under the 1996 Settlement to non-settlement recourse customers, (c) El Paso's proposed bifurcated cost of service is not just and reasonable, (d) El Paso has not met the 4,000 MMcf/d threshold to demonstrate that Article 11.2(b) rate protections were not triggered, and (e) El Paso's proposed successor-in-interest procedures are just and reasonable. The Commission remanded the issue of Article 11.2(b) compliance for further proceedings to address whether shippers protected by Article 11.2(b) would be charged costs of unsubscribed or discounted capacity under the rate proposal and, if so, to develop an appropriate remedy. The briefs on and opposing exceptions to the Initial Decision issued in that proceeding are addressed in a separate section below.

186. El Paso raises three arguments on rehearing. First, El Paso argues that, by rejecting El Paso's proposal to reallocate the Article 11.2 shortfall (the difference between maximum recourse rates and Article 11.2(a) rates), the Commission unreasonably departed from numerous prior orders that stated that El Paso would have a reasonable opportunity to recover all of its expansion costs. Second, El Paso argues that the Commission erred in remanding the Article 11.2(b) issues for hearing because the record demonstrates that El Paso has complied with Article 11.2(b) and has not proposed to shift 1995 discounted or unsubscribed capacity costs to eligible shippers. Finally, El Paso argues that the Commission erred by not finding that Article 11.2 is contrary to the public interest and/or produces unjust and unreasonable rates. As discussed more fully below, the Commission denies rehearing.

[308] 2011 Rate Case Suspension Rehearing, 133 FERC ¶ 61,253 at PP 14, 16.

1. Article 11.2 Shortfall

Request for Rehearing

187. El Paso argues that the Commission erred by requiring El Paso to absorb a large portion of its post-1995 expansion costs which are not covered by the Article 11.2(a) rate caps instead of allowing El Paso to recover those costs from non-Article 11.2 maximum recourse rate customers. El Paso argues that the Commission erred by ignoring the Presiding Judge's findings that the Article 11.2(a) rates are a unique type of maximum tariff rate and thus are not discounted rates. El Paso states that the Commission never addressed the argument that Article 11.2(a) rates are treated as maximum tariff rates in El Paso's Commission-approved tariff and thus may not be treated by the Commission as discounts in requiring El Paso to absorb any shortfall.[309]

188. El Paso argues that, in denying El Paso's proposed allocation of expansion costs, the Commission unreasonably departed from its prior orders which repeatedly held that El Paso would be given an opportunity to fully recover its expansion costs notwithstanding Article 11.2. El Paso argues that in Opinion No. 517, the Commission ignored a prior Commission order that indicated that in any future rulings on the issue of cost recovery for Post-Expansion capacity, El Paso would not be denied the ability to recover its expansion costs from all customers and that it did not intend to allow Article 11.2 to create any new "subsidized rates."[310] El Paso cites other prior orders where the Commission stated that "all customers will pay for the [expansion] capacity,"[311] that "Article 11.2(a) does not preclude inclusion of the costs of these expansions in all shippers' rates,"[312] that it would be "unreasonable to interpret Article 11.2(b) to require El Paso to absorb such costs, which only arise because of the expansions,"[313] and that "the former [full requirements] shippers would be required to bear the cost of the Expansion Capacity after the term of the 1996 Settlement."[314]

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[309] El Paso Rehearing at 117-119.

[310] *Id.* at 119-120 (citing *El Paso Natural Gas Co*., 109 FERC ¶ 61,359, at P 24 (2004) (establishing procedures for re-designating primary receipt and delivery points)).

[311] *Id.* at 120 (citing *El Paso Natural Gas Co*., 103 FERC ¶ 61,280, P 45 (2003) (Power-Up Project Certification Order)).

[312] *Id.* at 120-122 (citing March 20 Order, 114 FERC ¶ 61,290 at P 69).

[313] *Id.* at 123 (citing September 5 Order, 124 FERC ¶ 61,227 at P 98).

[314] *Id.* at 124 (citing September 5 Order, 124 FERC at P 105).

El Paso argues that, despite these assurances, the Commission has denied El Paso any opportunity to recover a large portion of its expansion costs.

Commission Determination

189. The Commission denies rehearing. In Opinion No. 517-A, the Commission rejected similar arguments raised by El Paso on rehearing.[315] In addressing El Paso's argument that the Commission has effectively denied El Paso full recovery of the costs it allowed El Paso to roll-in to its system rates, the Commission found that there is no guarantee that a pipeline will fully recover its costs if rolled-into system rates. The Commission stated that there are many factors that affect a pipeline's ability to fully recover costs, including whether the new capacity is fully subscribed, whether contracts are discounted, and whether the system is operated efficiently. The Commission further noted that El Paso made the decisions to roll-in the post-1995 expansion costs years after the 1996 Settlement was approved and with full knowledge of Article 11.2. El Paso raises no new arguments in this proceeding that would change the Commission's findings in Opinion No. 517-A.

2. Article 11.2(b) Remand

Request for Rehearing

190. El Paso argues that the Commission erred by setting Article 11.2(b) issues for hearing, rather than finding that El Paso has satisfied the Article 11.2(b) requirements. El Paso argues that the Commission erred by concluding that El Paso failed to meet the 4,000 MMcf/d presumption. El Paso contends that the Commission erred by refusing to count the maximum rate equivalent of the discounted contracts (MRE quantity). El Paso argues that the Commission, by excluding the MRE quantity simply because the contracts are priced below the rate cap, effectively treats that capacity as if El Paso had not received any revenues from the related contracts. El Paso claims that the Commission thus treats the equivalent of almost 1,000 MMcf/d of maximum rate capacity as if it were completely unsubscribed. El Paso theorizes that if it could recover all of its 1995 costs with revenues from discounted contracts, it would ensure that Article 11.2(b) shippers would not bear the cost of any unsubscribed or discounted 1995 capacity.[316]

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[315] Opinion No. 517-A, 152 FERC ¶ 61,039 at P 275.

[316] El Paso Rehearing at 125-127 (noting that it did not seek rehearing of this aspect of Opinion No. 517 because it was not aggrieved, due to the fact that the Commission found that El Paso had met the 4,000 MMcf/d presumption even without including the MRE quantity). El Paso states that, because El Paso now needs the MRE

(continued...)

191. El Paso argues that the Commission erred by not finding that the record shows that it has sufficient revenues to prevent any shift of 1995 costs to Article 11.2(b) shippers. El Paso states that the Commission indicated that a revenue analysis, properly done, can be used to determine whether 1995 discounted/unsubscribed capacity costs are being shifted to Article 11.2(a) shippers. El Paso argues that the Commission erred in failing to find that there is sufficient information in the record to make that determination without a hearing on remand. El Paso cites the Commission's statements that El Paso's revenue analysis fails to acknowledge that a substantial portion of the non-Article 11(a) contract revenues are discount rate contracts for which El Paso is seeking a discount adjustment and that if El Paso proposes to count such revenues, it must "demonstrate that the discount amounts are sufficient to ensure that Article 11.2(b) shippers are not being allocated costs attributable to discounted or unsubscribed 1995 capacity."[317] El Paso contends that the Commission failed to take the logical next step to assess whether the record readily allows such a determination.

192. El Paso argues that a contract-by-contract analysis is unnecessary because El Paso's revenues exceed its 1995 costs by a significant margin even without the discount adjustment. El Paso contends that, using the new cost of service and other requirements of Opinion No. 528, the total revenues produced by the rates required by Opinion No. 528 are approximately $537 million, the entire discount adjustment is approximately $93 million, yielding an adjusted revenue amount of approximately $444 million. El Paso's 1995 costs, as measured by the net plant cost of its 1995 facilities, are approximately $222 million. Therefore, El Paso concludes that its revenues significantly exceed its 1995 costs and the discount adjustment does not contain any 1995 costs; therefore no discounted/unsubscribed 1995 costs are reallocated to Article 11.2(b) shippers in the discount adjustment.[318] El Paso further contends that, even if all the post-1995 maintenance and pipeline safety expenses of approximately $255 million were included in the 1995 costs, El Paso's 1995 costs would be approximately $504 million.

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quantity to be included to meet the 4,000 MMcf/d presumption, El Paso is now aggrieved and the issue is now ripe.

[317] El Paso Rehearing at 128-130 (citing Opinion No. 528, 145 FERC ¶ 61,040 at P 530).

[318] *Id.* at 130-131 n.140 (citing Rehearing Appendix C, Ex. EPG-62, Ex. EPG-163).

El Paso argues that that is not materially different from El Paso's adjusted revenue level of approximately $500 million.[319]

193. El Paso argues that counting revenues from mainline expansion capacity to cover the cost of 1995 costs is not improper, but is in fact consistent with the Commission's reasoning supporting the 4,000 MMcf/day presumption. El Paso states that, in adopting the presumption the Commission explained that it is appropriate for El Paso to count all capacity sold at or above the Article 11.2(a) rate (including both 1995 capacity and post-1995 expansion capacity) toward the 4,000 MMcf/day presumption. El Paso reasons that it is also appropriate to consider revenues from all contracts, including post-1995 expansion capacity.[320]

194. El Paso argues that the Commission failed to address a second revenue test that El Paso submitted, which shows that its contract set during the test period provides more than enough total revenues to cover not only its 1995 capacity, but also all of the Line 2000 and Power-Up mainline expansion capacity, if all capacity were priced at the Article 11.2(a) rates.[321]

195. El Paso argues that the Commission should clarify the scope of the hearing, specifically that (a) the bar on "relitigation" of the issue applies solely to specific arguments actually litigated and decided in Opinion No. 528, such as whether El Paso's total revenue analysis was permissible or whether El Paso's peak day analysis demonstrated that it had satisfied the Article 11.2(b) threshold and (b) that it did not intend to bar the parties from litigating other issues that were not litigated before the Presiding Judge, including whether any portion of El Paso's discount adjustment includes discounted or unsubscribed 1995 costs, whether a revenue analysis using some revenue

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[319] El Paso Rehearing at 131 n.141 (citing Ex. EPG-163). El Paso characterizes its proposed attribution of maintenance and safety costs as conservative since some of the costs could be attributed to facilities constructed after 1995.

[320] *Id.* at 131-132 & nn.143, 144 (citing March 20 Order, 114 FERC ¶ 61,290 at PP 60, 63; September 5 Order, 124 FERC ¶ 61,227 at P 98). El Paso concludes that the Commission therefore considers that post-1995 expansion capacity is the first capacity that becomes unsubscribed and post-1995 expansion costs the first to be discounted.

[321] El Paso Rehearing at 133 (citing Ex. EPG-403). El Paso claims that the Presiding Judge erred by striking this evidence, mainly portions of El Paso's pre-filed direct testimony and supporting exhibits submitted by witnesses Palazzari and Rezendes that generally discuss and update data submitted in Docket No. RP08-426-000 regarding whether El Paso met the Article 11.2(b) requirements. At 133 n.145

level other than total revenues would be appropriate, and whether the costs of unsubscribed or discounted 1995 capacity are being shifted based on the facts of this case.[322]

Commission Determination

196. The Commission denies El Paso's request for rehearing. In Opinion No. 528, the Commission applied the Opinion No. 517 determinations with regard to Article 11.2(b) compliance and determined that El Paso did not meet the 4,000 MMcf/d threshold. El Paso argues that the Commission erred in not including the MRE quantity. However, as El Paso acknowledges, it did not seek rehearing of the Commission's determination in Opinion No. 517 that it was not reasonable to count MRE quantities toward satisfying the 4,000 MMcf/d threshold.[323] Notwithstanding its failure to seek rehearing of the issue in the prior proceeding, El Paso has not provided any new arguments or further support for including maximum rate equivalents toward the threshold. Consequently, we deny rehearing, consistent with the determination in Opinion No. 517 that the Commission did not count maximum rate equivalents when it established the threshold in the March 20 Order.[324] El Paso has not provided data and analysis to demonstrate that customers are not being charged 1995 system costs in violation of Article 11.2(b).

197. El Paso argues that the Commission erred in finding that El Paso's revenue study is insufficient to show that El Paso did not meet the requirements of Article 11.2(b). El Paso's study compared its 1995 costs, as measured by the net plant cost of its 1995 facilities, with total revenues and concluded that revenues would exceed the 1995 costs even if all the post-1995 maintenance and pipeline safety expense were added to the 1995 costs. The Commission determined, however, that El Paso's revenue analysis fails to acknowledge that a substantial portion of the non-Article 11.2(a) contract revenues are discount rate contracts for which the Commission granted El Paso a discount adjustment. The Commission noted that the Article 11.2(a) shippers that also hold maximum recourse rate contracts will therefore be paying a share of that discount adjustment. The

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[322] El Paso Rehearing at 133-134.

[323] *See id.* at 125-127.

[324] Opinion No. 517, 139 FERC ¶ 61,095 at P 329. *See also* March 20 Order, 114 FERC ¶ 61,290 at P 60 ("if El Paso has 4000 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"). The court of appeals affirmed the Commission's setting the threshold at 4,000 MMcf/d in *Freeport*, 669 F.3d 302, 312. The threshold was not otherwise challenged.

Commission concluded that, if El Paso proposes to count those discounted contract revenues to show compliance with Article 11.2(b), it must demonstrate that the discounted amounts are sufficient to ensure that Article 11.2(b) shippers are not being allocated costs attributable to discounted or unsubscribed 1995 capacity through the discount adjustment mechanism.[325]

198. El Paso argues that the Commission failed to take the logical next step to assess whether the record readily allows such a determination. We disagree. Given the complex record and the divergent contentious positions of multiple parties, it was evident that the record did not readily allow the Commission to determine whether El Paso included the cost of discounted 1995 capacity in violation of Article 11.2(b). It was for this very reason that it was necessary for the Commission to remand the issue to the Presiding Judge. Because El Paso failed to provide a convincing analysis to address the issues raised by Article 11.2(b), it was necessary to seek additional input. However, El Paso has again failed on remand to provide a reliable analysis to address the concerns raised by Article 11.2(b).

199. El Paso updates its revenue study on rehearing to reduce the revenues by the full discount adjustment, yielding an adjusted revenue level of approximately $500 million and a 1995 cost (including all post-1995 maintenance and pipeline safety expenses) of $504 million. El Paso concludes that the adjusted 1995 costs of $504 million are “not materially different” from the adjusted revenue level of approximately $500 million. The Commission considers a difference of $4 million, however, to indeed be material, especially as this figure is to be compared, not to El Paso’s service as a whole, but to the service volumes for the shippers who are to be charged the costs of the unsubscribed and undersubscribed 1995 capacity. Consequently, the Commission finds that El Paso’s analysis does not support its position that the revenue study demonstrates compliance with the requirements of Article 11.2(b).

200. Finally, El Paso argues that the Commission should clarify the scope of the hearing, specifically that the bar on relitigation does not include issues that were not litigated, such as whether any portion of the discount adjustment includes discounted or unsubscribed 1995 costs, whether a revenue analysis using some revenue level other than total revenues would be appropriate, and whether the costs of unsubscribed or discounted 1995 capacity are being shifted. The Commission notes that those issues were litigated in the remand proceeding; thus El Paso’s request for clarification is moot.

[325] Opinion No. 528, 145 FERC ¶ 61,040 at P 530.

3. <u>Just and Reasonable Review</u>

<u>Request for Rehearing</u>

201. El Paso argues that the Commission erred by not finding that Article 11.2 is against the public interest and/or produces unjust and unreasonable rates. El Paso argues that the Commission failed to address the fact that rejecting the Article 11.2 rates as unjust and unreasonable does not require any change to the terms of Article 11.2 and thus is not governed by the *Mobile-Sierra* standard. El Paso argues that the plain language of Article 11.2(a) does not establish a fixed rate or constitute a fixed rate contract within the meaning of the *Mobile-Sierra* doctrine, but merely establishes a proposed rate; therefore, the Commission should not read a fixed rate into the language of Article 11.2. El Paso contends that the Commission ignored its argument and case law supporting the just and reasonable issue in Opinion No. 517, nor did the Commission rule on this argument in any prior order. Thus, El Paso asserts that the Commission erred by calling El Paso's argument a "collateral attack" and ignoring the argument once again.[326]

202. El Paso argues that the record evidence in this case, which has not been considered previously, demonstrates the Article 11.2(a) rates are unjust and unreasonable and against the public interest. El Paso argues that Opinion No. 528 relies on Opinion No. 517 to reject El Paso's argument, but that reliance is misplaced because that order was wrongly decided, as detailed in El Paso's request for rehearing of Opinion No. 517. El Paso argues that factual conditions have changed fundamentally since the 1996 Settlement was negotiated in ways that the parties never contemplated and that the Settlement never was intended to address. El Paso argues that, due to such changes, Article 11.2 was producing a misallocation of cost responsibility by the time of the 2008 Rate Case. El Paso contends that allowing Article 11.2 shippers to avoid an equal share of responsibility for the post-1995 expansion costs they demanded, thus preferentially lowering their rates below the level paid by other similarly-situated shippers, is neither in the public interest nor just and reasonable.[327]

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[326] El Paso Rehearing at 135-137 & n.146 (citing *Papago Tribal Utility Authority v. FERC*, 723 F.2d 950, 953 (D.C. Cir. 1983); *Morgan Stanley Capital Group, Inc. v. Pub. Util. Dist. No. 1*, 554 U.S. 527, 534 (2008) (citing *Papago* with approval)).

[327] El Paso Rehearing at 138-139 (claiming that the Presiding Judge erred by striking, on January 6, 2011, those portions of El Paso's pre-filed direct testimony and supporting exhibits which reference El Paso's set of alternate tariff records, but are directly relevant to the issues of whether Article 11.2 is in the public interest and whether the proposed Article 11.2 rates are unjust and unreasonable).

203. El Paso also argues that the Commission failed to address new facts in the record after the 2008 Rate Case test period, such as the number of turnbacks by Article 11.2 shippers and the related impact on relative rate and cost responsibility levels. El Paso asserts that the Article 11.2 shippers, including APS and others, have turned back almost 300,000 Dth/day of capacity since the 2008 Rate Case test period and almost 600,000 Dth/day in total. El Paso states that the amount of turnback by Article 11.2 shippers now exceeds the 550 MMcf/day capacity of the Line 2000 and Power-Up expansion projects.[328] El Paso argues that the impact of Article 11.2 on El Paso's rates has grown more acute in the instant proceeding because Article 11.2 shippers chose to reduce their non-Article 11.2 service on El Paso facilities, shift a portion of their needs to competing pipelines at a higher price, and yet continue to demand the benefits of Article 11.2 for their remaining El Paso service. El Paso concludes that Article 11.2 misallocates responsibility for the post-1995 expansion costs, results in undue discrimination and places excessive burdens on third parties, none of which is in the public interest or just and reasonable.[329]

204. El Paso argues that Opinion No. 528 mischaracterized the bargain struck in Article 11.2, contrary to prior orders where the Commission stated that Article 11.2 was only intended to protect eligible contracts from the costs of unsubscribed and discounted 1995 capacity.[330] El Paso contends that it was never intended to protect such contracts from post-1995 expansion costs, nor was it intended to give shippers a competitive advantage over other shippers using newly-constructed facilities. El Paso asserts that the Commission thus erred in failing to recognize that Article 11.2 shippers are similarly situated with other shippers concerning responsibility for the costs of these post-1995 facilities.[331]

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[328] *Id.* at 139-141 (citing Ex. EPG-211 at 9-12; Ex. EPG-324 at 4-6; Ex. EPG-328).

[329] *Id.* at 141.

[330] *Id.* at 142 (citing Opinion No. 528, 145 FERC ¶ 61,040 at P 451; March 20 Order, 114 FERC ¶ 61,290 at PP 16-17; September 5 Order, 124 FERC ¶ 61,227 at P 18).

[331] *Id.* at 142-143 & n.160 (stating that, contrary to the Commission's unsupported statement in Opinion No. 528 P 451, the settlement obligations undertaken by the Article 11.2 shippers do not support the significant rate advantage they currently enjoy because those obligations, in the form of risk-sharing payment, only applied to El Paso's 1995 capacity costs and not to the post-1995 expansion costs. In addition, the benefits the Article 11.2 shippers received almost fully repaid the costs they incurred).

205. El Paso argues that the Commission also erred in relying on the Presiding Judge's conclusion that the rate differential between Article 11.2 contracts and non-Article 11.2 contracts "is almost exclusively attributable to El Paso's need to offer discounts in response to competition, primarily in California." El Paso argues that that conclusion ignores unrebutted evidence showing that, in addition to competition in California, El Paso has had to discount its capacity because of two other major factors: (a) the large capacity turnbacks by East of California shippers and (b) the significant costs of the post-1995 expansion capacity that those shippers demanded be constructed. El Paso argues that, without those factors, it would have faced significantly less pressure to discount its capacity.[332]

206. Finally, El Paso argues that the Commission erred by failing to consider the record in the instant case jointly with the record in Docket No. RP08-426-000, the 2008 Rate Case. El Paso contends that neither case alone encompasses the entire evidentiary record relevant to determining whether Article 11.2 remains in the public interest or results in just and reasonable rates.[333]

Commission Determination

207. The Commission denies El Paso's request for rehearing. Many of El Paso's arguments are similar to those that the Commission rejected on rehearing in Opinion No. 517-A, as discussed below.

208. El Paso argues that the Commission erred by not finding that Article 11.2 is against the public interest and/or produces unjust and unreasonable rates. As the Commission found in Opinion No. 517-A, a determination that the Article 11.2(a) rates are just and reasonable relies on a determination that the Article 11.2(a) rates proposed by El Paso are consistent with the 1996 Settlement.[334] To find otherwise would require modification or abrogation of the 1996 Settlement based on a finding that Article 11.2 of the 1996 Settlement no longer meets the *Mobile-Sierra* public interest standard. Just as in the 2008 Rate Case proceeding, no party in the instant proceeding has yet met the *Mobile-Sierra* public interest standard to support such a change.

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[332] *Id.* at 143 & n.160 (citing Opinion No. 528, 145 FERC ¶ 61,040 at P 451; Ex. EPG-211 at 29-30).

[333] *Id.* at 143-144.

[334] Opinion No. 517-A, 152 FERC ¶ 61,039 at PP 220-221.

209. El Paso argues that rejecting the Article 11.2 rates as unjust and unreasonable does not require any change to the terms of Article 11.2 and thus is not governed by the *Mobile-Sierra* standard. This argument was also addressed in Opinion No. 517-A where the Commission found that a request to modify or eliminate Article 11.2(a) rates, or to find those rates not just and reasonable, is the functional equivalent of a proposed change to the 1996 Settlement.[335] Approving an Article 11.2(a) rate higher than the fixed contract rate set forth in the 1996 Settlement would be inconsistent with the 1996 Settlement and would constitute a change to the 1996 Settlement that must be supported under the public interest standard of the *Mobile-Sierra* doctrine.

210. El Paso argues that the plain language of Article 11.2(a) does not establish a fixed rate or constitute a fixed rate contract within the meaning of the *Mobile-Sierra* doctrine. We disagree. As the Commission found in Opinion No. 517-A, Article 11.2(a) rates are rates capped by the 1996 Settlement and adjusted annually by an inflation adjustment. No other adjustment to the Article 11.2(a) rates is allowed, absent a *Mobile-Sierra* public interest showing.[336]

211. El Paso argues that the Commission did not address the record evidence in this proceeding which demonstrates that the factual conditions have changed fundamentally since the 1996 Settlement in ways the parties never contemplated and that the Settlement was not intended to address. El Paso further argues that the Opinion No. 528's reliance on Opinion No. 517 to reject El Paso's argument is misplaced because Opinion No. 517 was wrongly decided. We disagree. The Commission denied El Paso's request for rehearing of this issue in Opinion No. 517-A and affirmed the finding that El Paso and the other parties in the 2008 Rate Case requesting abrogation of Article 11.2 had failed to carry their burden of showing extraordinary circumstances that merit abrogation of Article 11.2.[337] In Opinion No. 528, the Commission affirmed the Presiding Judge's finding that the asserted changed circumstances since the end of the test period in the 2008 Rate Case do not support a determination that Article 11.2 rates are not in the public interest or are unjust and unreasonable, or unduly discriminatory.[338] Contrary to El Paso's allegations, the Commission based its finding on a review of the record, including briefs and exhibits. The Commission reviewed the evidence, including that detailing the level of turnback capacity, the rate differential between Article 11.2 and recourse rates,

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[335] *Id.* P 223.

[336] *Id.* P 225.

[337] *Id.* P 241.

[338] Opinion No. 528, 145 FERC ¶ 61,040 at PP 449-452.

and the other changed circumstances, and found that El Paso and the Competitive Power Suppliers failed to demonstrate extraordinary circumstances, excessive third party burdens or undue discrimination required to modify Article 11.2 under the *Mobile-Sierra* standard.[339] Thus, after each review of the records in both the 2008 and 2011 Rate Cases, the Commission has found that changed circumstances do not merit abrogation of Article 11.2.

212. El Paso further argues that the Commission erred by failing to consider the record in the instant case jointly with the record in the 2008 Rate Case. As discussed above, however, the Commission reviewed the record in the instant case and determined that the asserted changed circumstances (i.e., the rate differential) did not support a finding that the Article 11.2 rates are not in the public interest. Due to the nature of the Article 11.2 rates, which increase each year by an inflation factor, the current rate differential is essentially the culmination of changes since the 1996 Settlement. Nevertheless, the Commission reviews the record in the instant proceeding to determine just and reasonable rates for a pipeline.

213. El Paso argues that Opinion No. 528 mischaracterized the bargain struck in Article 11.2, contrary to prior orders where the Commission stated that Article 11.2 was "only intended to protect eligible contracts from the costs of unsubscribed and discounted 1995 capacity." However, the prior orders cited by El Paso simply summarize and quote the provisions in Article 11.2 and do not state that Article 11.2 was "only" to protect eligible contracts from the costs of unsubscribed and discounted 1995 capacity. Article 11.2 is part of the complex balancing of risks and rewards embodied in the 1996 Settlement. While Article 11.2 may not have anticipated post-1995 expansion costs or that shippers protected by Article 11.2 may enjoy a competitive advantage over non-Article 11.2 shippers, such unintended consequences in and of themselves do not support a finding that Article 11.2 is not in the public interest.

214. El Paso argues that the Commission erred in relying on the Presiding Judge's conclusion that the rate differential between Article 11.2(a) rates and non-Article 11.2(a) rates "is almost exclusively attributable to El Paso's need to offer discounts in response to competition, primarily in California."[340] El Paso argues that the Commission's conclusion ignores unrebutted evidence showing that the need to discount was increased by the large capacity turnbacks by East of California shippers and the significant costs of the post-1995 expansion capacity that those shippers demanded be constructed. We disagree. As the Commission noted in Opinion No. 528, the record shows that the

[339] *Id.* P 452.

[340] El Paso Rehearing at 143 (citing Opinion No. 528 at P 451).

average rate paid by El Paso's discounted shippers is significantly lower than the maximum recourse rates. Capacity turnbacks are generally driven by many diverse factors, such as economic downturns, the need for supply diversification, changing end use markets, and others. Natural gas pipelines experience fluctuating periods of discount activity, as evidenced by El Paso's history of swinging between undersubscribed and oversubscribed capacity. Furthermore, El Paso's argument does nothing to address the Commission's finding that the rate differential is justified because the Article 11.2 shippers took on greater obligations than non-settling shippers – in particular, the risk sharing payments and settlement of the controversy over the 1995 turnbacks.

E. Return On Equity and El Paso's Placement in the Proxy Group

215. In Opinion No. 528, the Commission affirmed the Presiding Judge's rulings regarding the composition of the proxy group and the application of the Commission's two-step discounted cash flow (DCF) analysis to that group. Based on that DCF analysis, and a five member proxy consisting of Boardwalk Pipeline Partners, LP (Boardwalk); TC Pipelines, LP (TC Pipelines); Spectra Energy Partners, LP (Spectra Partners); Spectra Energy Corporation (Spectra Corporation); and Williams Partners, LP (Williams), the Commission determined that the range of reasonableness for El Paso's return on equity (ROE) is 10.39 percent to 11.08 percent, with a median of 10.55 percent. In arriving at this determination, the Commission upheld the Presiding Judge's finding that the long-term growth rate for master limited partnerships (MLPs) should be one-half of gross domestic product (GDP), instead of El Paso's full GDP proposal based on its proposed "Benchmark Model." The Commission also reversed the Presiding Judge's finding that El Paso's relative risk justified an ROE "well above the median," finding instead that El Paso's allowed ROE should be set at the median of the range of reasonableness, or 10.55 percent.

216. On rehearing, El Paso challenges the Commission's approval of the Presiding Judge's proxy group, the finding that one-half GDP should be used as the MLP long term growth component in the two-step DCF analysis, and the decision to place El Paso at the median of the range of reasonable returns. As discussed more fully below, we deny El Paso's request for rehearing on these issues.

1. Proxy Group Composition

217. As discussed in the Commission's *Policy Statement* on the *Composition of Proxy Groups for Determining Gas and Oil Pipeline Return on Equity*,[341] the Supreme Court

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[341] *Composition of Proxy Groups for Determining Gas and Oil Pipeline Return on Equity*, Policy Statement, 123 FERC ¶ 61,048, *reh'g dismissed*, 123 FERC ¶ 61,259 (2008) (Proxy Group Policy Statement or Policy Statement).

has held that "the return to the equity owner should be commensurate with the return on investment in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital."[342] In order to attract capital, "a utility must offer a risk-adjusted expected rate of return sufficient to attract investors."[343] In theory, this requires an evaluation of the regulated firm's needed return compared to other regulated firms of comparable risk.

218. Most natural gas pipelines are wholly-owned subsidiaries and their common stock is not publicly traded. Therefore, the Commission performs a DCF analysis of publicly-traded proxy firms to determine the return the equity markets require a pipeline to give its investors in order for them to invest their capital in the pipeline. As the court explained in *Petal Gas Storage, LLC v. FERC*,[344] 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 those 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.'"[345] It is thus crucial that the firms in the proxy group be comparable to the regulated firm whose rate is being determined. In other words, as the court emphasized in *Petal Gas v. FERC*, the proxy group must be "risk-appropriate."[346]

219. Historically, the Commission required that each company included in the proxy group satisfy three standards: (1) the company's stock must be publicly traded; (2) the company must be recognized as a natural gas company and its stock must be recognized and tracked by an investment information service, such as the Value Line Investment Survey; and (3) pipeline operations must constitute a high proportion of the company's business.[347] This last standard could only be satisfied if a company's pipeline business

[342] *Hope*, 320 U.S. 591 at 603.

[343] *Canadian Ass'n Petroleum Producers v. FERC*, 254 F.3d 289, 293 (D.C. Cir. 2001) (*CAPP v. FERC*).

[344] 496 F.3d 695 (D.C. Cir. 2007) (*Petal Gas v. FERC*).

[345] *Petal Gas v. FERC*, 496 F.3d at 697 (quoting *CAPP v. FERC,* 254 F.3d 289 at 293).

[346] *Id.*

[347] *Williston Basin Interstate Pipeline Co.,* 104 FERC ¶ 61,036, at PP 34-43 (2003).

accounted for, on average, at least 50 percent of either a company's assets or its operating income over the most recent three-year period.[348]

220. In 2008, the Commission reexamined its policy concerning the composition of the proxy group in light of the fact that mergers and acquisitions had reduced the number of publicly-traded corporations that satisfied the Commission's historical proxy group standards. At the same time, an increasing number of MLPs owned natural gas pipelines.

221. In light of these developments, the Commission issued the Proxy Group Policy Statement concerning the composition of the proxy groups used to determine jurisdictional natural gas and oil pipelines' ROE under the two-step DCF model.[349] The Commission concluded: (1) MLPs could be included in the ROE proxy group for natural gas pipelines; (2) there should be no cap on the level of an MLP's distributions included in the dividend yield component of the two-step DCF methodology; (3) the Institutional Brokers' Estimate System (IBES) forecasts would remain the basis for the short-term growth forecast used in the two-step DCF calculation for both corporations and MLPs; (4) there should be an adjustment to the long-term growth rate used to calculate the cost of equity capital for an MLP; and (5) there would be no modification to the current respective two-thirds and one-third weightings of the short- and long-term growth factors. The Commission stated that the Proxy Group Policy Statement made no findings as to which particular corporations and/or MLPs should be included in the natural gas or oil proxy groups. The Commission left that determination to each individual rate case. The Commission did provide general criteria for the inclusion of MLPs in proxy groups, namely: (i) the MLP should be tracked by Value Line; (ii) the MLP should have been in existence for at least five years; and (iii) the MLP should derive at least 50 percent of its operating income from, or have 50 percent of its assets devoted to, interstate operations.[350] The Commission further noted that there might be individual MLPs that do not satisfy the criteria described above but may still be appropriate for inclusion in the proxy group.

222. The Commission applied the Proxy Group Policy Statement in Opinion Nos. 486-B and 486-C.[351] In those opinions, the Commission restated its preference

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[348] *Id.* P 35 n.46.

[349] Proxy Group Policy Statement, 123 FERC ¶ 61,048.

[350] *Id*. P 79.

[351] *Kern River Gas Transmission Co.,* Opinion No. 486, 117 FERC ¶ 61,077 (2006), *order on reh'g,* Opinion No. 486-A, 123 FERC ¶ 61,056 (2008), *order on reh'g,* Opinion No. 486-B, 126 FERC ¶ 61,034, *order on reh'g,* Opinion No. 486-C, 129 FERC

(continued...)

that proxy firms satisfy the Commission's standard that 50 percent of their income or assets be in the pipeline business.[352] However, in that case, only three firms satisfied the 50 percent standard. In addition to those three firms, the Commission also included in the proxy group one MLP and one diversified natural gas corporation, finding those two firms "were the two other, most risk appropriate firms to add to the proxy group in order to achieve a five-member group."[353] The MLP was Kinder Morgan Energy Partners (KMEP), whose operations and assets were about 35 percent natural gas pipeline business, 35 percent oil pipeline business, and 30 percent CO2 pipeline and terminal operations. The Commission found that KMEP's risks were sufficiently comparable to Kern River's for it to be included in the proxy group, because its combined natural gas and oil transmission business substantially exceeded 50 percent and the natural gas transmission business was at least as great as the oil transmission business.[354]

223. The diversified natural gas corporation the Commission included in the Kern River proxy group was National Fuel Gas Company (National Fuel). National Fuel's net income profile was approximately 28 percent local distribution, 28 percent natural gas transportation, and 32 percent exploration and production. The Commission found that local distribution is generally less risky than transportation, but exploration and production are generally more risky.[355] Therefore, the Commission stated that a diversified natural gas corporation should be excluded from the proxy group if either of its less risky distribution or more risky market-oriented functions substantially outweighs its transmission functions or each other.[356] However, Opinion No. 486-C held that such a firm may be included in the proxy group, if it is shown that: (i) the combined natural gas pipeline and distribution businesses of the firm make up at least 50 percent of its total business; (ii) the natural gas pipeline business is at least equal to the distribution business; and (iii) the firm's more risky exploration, production, and other market-oriented businesses are no greater than the less risky distribution business.[357] The Commission

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¶ 61,240 (2009).

[352] Opinion No. 486-B, 126 FERC ¶ 61,034 at P 91; Opinion No. 486-C, 129 FERC ¶ 61,240 at PP 60, 70.

[353] Opinion No. 486-C at P 47.

[354] *Id*. PP 34, 47-51.

[355] *Id*. PP 57-71.

[356] Policy Statement, 123 FERC ¶ 61,048 at P 51.

concluded that National Fuel satisfied these standards, and accordingly the Commission included National Fuel in the proxy group in order to achieve a proxy group of at least five members.

224. The Commission also applied the *Proxy Group Policy Statement* in Opinion No. 510,[358] issued in a Portland Natural Gas Transmission System (Portland) NGA section 4 rate case. In that case, the Commission approved a proxy group with six members, all of whom satisfied the 50 percent standard. The Commission excluded various other firms from the proxy group, including KMEP and National Fuel. The Commission explained that, having adopted a six-member proxy group that satisfied the 50 percent standard, there was no need to proceed to a second step to try to include companies that do not meet that standard.[359]

Opinion No. 528

225. Opinion No. 528 affirmed the Presiding Judge's findings that the proxy group should include four MLPs (Boardwalk, TC Pipelines, Spectra Partners, and Williams) and one corporation (Spectra Corporation).[360] As we noted in Opinion No. 528, the active parties to the proceeding that commented on the proxy group composition, El Paso, Trial Staff, and Indicated Shippers, all agreed that the proxy group should include Boardwalk, TC Pipelines, and Spectra Partners. In affirming the Presiding Judge's selection of these companies the Commission found that "[s]ignificantly, 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 natural gas pipeline operations."[361]

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[357] Opinion No. 486-C, 129 FERC ¶ 61,240 at P 71; *see also* Opinion No. 486-B, 126 FERC ¶ 61,034 at P 91-92, 94, 97-99.

[358] *Portland Natural Gas Transmission System*, Opinion No. 510, 134 FERC ¶ 61,129, at PP 163-224 (2011).

[359] *Id.* PP 215 and 221.

[360] Opinion No. 528, 145 FERC ¶ 61,040 at P 621.

[361] *Id*.

226. Spectra Corporation also satisfied the 50 percent standard. While El Paso suggested that the inclusion of Spectra Corporation would create redundancies due to the overlap of its business with that of Spectra Partners, it did not object to Spectra Corporation's inclusion in the proxy group.[362] Accordingly, Opinion No. 528 approved the inclusion of Spectra Corporation, rejecting El Paso's redundancy argument, consistent with the findings in Opinion No. 510.[363]

227. Indicated Shippers advocated the selection of El Paso Corporation over Williams Partners as the fifth proxy group member. We nevertheless approved the Presiding Judge's selection of Williams over El Paso Corporation as the fifth proxy group member, despite the fact El Paso Corporation satisfied the 50 percent test but Williams did not. The Commission explained that El Paso Corporation reduced its dividend in 2010, which can distort a DCF analysis. Also, El Paso Corporation was the target of an acquisition by Kinder Morgan, Inc. (Kinder Morgan), which can also affect the reliability of a DCF result. The Commission also found that Williams' assets and operating income were only slightly below the 50 percent standard, with 47.46 percent of its assets devoted to interstate pipeline operations and 44.70 percent of its operating income from interstate pipeline operations.[364] Accordingly, based on the totality of the circumstances, the Commission approved the Presiding Judge's choice of Williams as the fifth proxy group member.[365]

228. In addition to the five entities the Presiding Judge and the Commission approved for inclusion in the proxy group, El Paso also proposed to include three additional MLPs: KMEP, ONEOK Partners, LP (ONEOK), and Enterprise Products Partners, LP (Enterprise). El Paso asserted that, despite the fact that these entities did not satisfy the 50 percent standard, including additional companies in the proxy group would produce a more accurate result from a statistical standpoint. The Presiding Judge rejected the inclusion of the companies proposed by El Paso, finding that the Commission endorses proxy groups of larger than five members "only if every constituent member strictly satisfies the 50% Standard," and that none of the three proposed by El Paso satisfy the

[362] *See id.* P 622.

[363] *Id.* (citing Opinion No. 510, 134 FERC ¶ 61,129 at PP 192-195).

[364] *Id.* P 602.

[365] *Id.* PP 632-635.

50 percent test.[366] The Commission affirmed the Presiding Judge's rejection of these companies on the same basis.[367]

Request for Rehearing

229. El Paso requests rehearing of the Commission's determination to exclude KMEP, ONEOK and Enterprise from the proxy group. According to El Paso, although the Commission has applied the 50 percent test in the past, it has recently relaxed that standard and recognized that it need not be strictly applied.[368] El Paso claims accordingly that the Presiding Judge's refusal to include these three companies in the proxy group on the basis they did not satisfy the test, and the Commission's affirmation thereof, was inconsistent with holdings that the rule is not absolute. El Paso asserts that "all three companies had (1) at least 50 percent of their assets or income devoted to FERC-regulated interstate pipeline operations, including natural gas, natural gas liquids (NGLs), [and] oil or petroleum products; and (2) at least 25 percent of their assets or income devoted exclusively to regulated natural gas pipelines."[369] El Paso further states that none of the companies had significant exploration, production, marketing or distribution activity. El Paso claims that based on these factors, the companies are "FERC-regulated transmission companies with a substantial, albeit less than 50 percent, ownership interest in natural gas pipelines."[370]

230. El Paso argues that the Commission erred by affirming the Presiding Judge's rejection of these companies on the basis that they do not meet the 50 percent test, even though it acknowledges that the test is not absolute. El Paso claims that it was unreasonable for the Commission to relax the standard to allow the inclusion of Williams in the proxy group, and then reject the inclusion of three others solely for failure to meet the same standard, and without performing a risk analysis. Specifically, El Paso claims

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[366] *Id.* PP 624-625.

[367] *See id.* P 605. Indicated Shippers also proposed that TransCanada Corporation (TransCanada), Southern Union Company (Southern Union), and El Paso Pipeline Partners, LP, be included in the proxy group. The Presiding Judge and the Commission rejected that proposal, Opinion No. 528, 145 FERC ¶ 61,040 at P 626, and Indicated Shippers have not sought rehearing of the ruling.

[368] El Paso Rehearing at 51-52.

[369] *Id.* at 52.

[370] *Id.*

the Commission (1) failed to analyze the ultimate issue of whether these companies have comparable risks to El Paso; (2) failed to acknowledge its prior holdings that the risks of companies engaged in oil and products transmission are commensurate to natural gas pipeline operations; (3) failed to acknowledge and address its previous acceptance of one of these three companies, KMEP, in a natural gas pipeline proxy group; and (4) failed to acknowledge its prior findings that larger proxy groups are statistically more reliable.[371]

231. On the first point, El Paso asserts that the Commission ignored substantial and largely uncontroverted testimony from its expert witness, Dr. Michael J. Vilbert, demonstrating that the current market and regulatory environments relating to the transportation of oil pipelines do not materially differ from those of interstate natural gas pipeline operations, and that both have comparable risks and costs of capital.[372] El Paso claims that Dr. Vilbert explained that the primary difference between interstate natural gas pipelines and oil pipelines is that the former are regulated by the Commission as contract carriers that provide service pursuant to long-term or short-term contracts, while the latter are regulated by the Commission as common carriers that historically have sold capacity on a day-to-day basis. El Paso states that Dr. Vilbert's testimony shows that the relative insulation from risk that firm long-term contracts may have provided natural gas pipelines in the past relative to oil pipelines is no longer a material factor due to increased competition between natural gas pipelines and longer term firm contracts for transportation on oil pipelines. El Paso claims that Opinion No. 528 failed to address any of the evidence presented by Dr. Vilbert.

Commission Determination

232. We deny rehearing of the determination in Opinion No. 528 to exclude KMEP, ONEOK and Enterprise from the proxy group. As discussed below, the Commission relied on the Presiding Judge's sound analysis and reasonable application of existing Commission policy in the selection of the adopted proxy group companies. The record shows that the Presiding Judge found that four companies satisfied the Commission's historical criteria for inclusion in the proxy group. In order to achieve a five-member proxy group, the Presiding Judge carefully analyzed the remaining companies at issue. After rejecting El Paso Corporation for reasons which El Paso does not contest, the Presiding Judge chose the one company – Williams – that was the closest to meeting the Commission's 50 percent test and had an investment grade credit rating, consistent with our policy and precedent. Indeed, El Paso does not challenge the choice of Williams as a proxy group member, except in the context of its argument that it is not fair to relax the

[371] *Id.* at 53.

[372] *Id.* at 56 (citing Ex. EPG-170 and Ex. EPG-310).

50 percent test for Williams and not also do so for its suggested additions. As further discussed below, however, once the Presiding Judge had established a five-member proxy group that was risk comparable to El Paso and most closely satisfied the Commission's historical criteria, it was not incumbent upon him to include additional companies that did not meet those standards in the group to obtain a purportedly more "statistically reliable" result.

233. As noted above, the only proxy group issue on rehearing is whether the Commission properly upheld the Presiding Judge's decision to exclude KMEP, ONEOK, and Enterprise from the proxy group in this case. We deny rehearing of that determination.

234. Despite El Paso's arguments regarding the relaxation of the 50 percent rule, and its claims that the rule is not absolute, the Commission's stated preference is that proxy firms satisfy the Commission's historical standard that 50 percent of their income or assets be in the interstate natural gas pipeline business.[373] Thus, as we noted in *Portland*, we will relax the 50 percent standard only when necessary to achieve a proxy group of at least five companies and "only if there is a convincing showing that an investor would view that firm as having comparable risk to a pipeline."[374]

235. In the instant proceeding there is no question that Boardwalk, TC Pipelines, Spectra Partners and Spectra Corporation all satisfy the Commission's historical test for inclusion in a proxy group, including the 50 percent test. According to Trial Staff's analysis of the 2010 Form 10-K financial data provided by these companies to the Securities and Exchange Commission, interstate natural gas pipeline business accounts for (1) 95.68 percent of Boardwalk's assets, (2) 100 percent of TC Pipeline's assets and operating income, (3) 58.45 percent of Spectra Partners' assets and 59.78 percent of its operating income, and (4) 53.94 percent of Spectra Corporation's operating income.[375]

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[373] *See, e.g.*, *Portland*, Opinion No. 510, 134 FERC ¶ 61,129 at P 167 (citing Opinion No. 486-B, 126 FERC ¶ 61,034 at P 91 and Opinion No. 486-C, 129 FERC ¶ 61,240 at PP 60, 70).

[374] *Id*.

[375] *See, e.g.*, Ex. S-10 at 16 and Ex. S-11, Schedule No. 9. As described above, historically the Commission applied the 50 percent standard based on a three-year average of a company's business operations. However, since the Policy Statement, the Commission has focused only on asset and income data for the most recent year. *See, e.g.*, Opinion No. 486-B, 126 FERC ¶ 61,034 at PP 62, 67, 76, 97, and 99, and *Portland*, Opinion No. 510, 134 FERC ¶ 61,129 at PP 170 and 181. As staff's witness testified, the cost of equity for a company is forward-looking and only properly considers investors'

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Thus the Presiding Judge correctly included them in the proxy group as risk comparable to El Paso. Further, consistent with the Commission's determination in *Portland*, the Presiding Judge relaxed the 50 percent standard in order to establish a proxy group of at least five companies. In so doing, the Presiding Judge chose Williams, the remaining company that met the other criteria and came the closest to satisfying the 50 percent test, with 44.70 percent of its operating income derived from and 47.46 percent of assets devoted to interstate natural gas pipeline operations.

236. In its rehearing request, El Paso claims that the 50 percent test is not "absolute" and makes numerous arguments about why the Presiding Judge and the Commission should have expanded the proxy group to include its preferred companies, KMEP, ONEOK and Enterprise. The fact that the Commission has relaxed the rule in certain circumstances to ensure that a proxy group can be established that contains at least five members, however, does not mean that the Commission will relax the standard for all proposed proxy group members in order to include them. Thus, there is nothing in our precedent that required the Presiding Judge to continue to assess the appropriateness of including companies that clearly did not meet the Commission's established criteria once he established a proxy group of five companies that did meet those tests. As we have found previously, we will relax the standard only if necessary to establish a proxy group consisting of at least five members and "only if there is a convincing showing that an investor would view that firm as having comparable risk to a pipeline." Here, having developed a proxy group of four companies that met the criteria, the Presiding Judge relaxed the 50 percent standard to allow the remaining company that most nearly met that test into the group so that it would contain at least five members. At that point, it was not necessary for him to engage in the complicated and difficult analysis of the type undertaken by El Paso in its rehearing request in order to justify the inclusion of additional companies that did not satisfy those criteria, and were not shown to be risk comparable.

237. As noted above, the Commission's preference for proxy group companies, including MLPs, is that they meet the 50 percent test. Here, despite El Paso's various arguments as to the make-up of its proposed companies and its proposed distinction between natural gas and oil transmission and non-transmission assets, the record shows that the companies rejected by the Presiding Judge do not come as close to satisfying the test as Williams. As discussed in more detail below, KMEP has at most 39 percent of its assets devoted to natural gas pipeline business and ONEOK and Enterprise have even

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expectations and risk assessment of the company's business operations going forward, which is generally best represented by the most recent asset and income data available. Ex. S-10 at 14.

less of their assets devoted to the natural gas pipeline business. El Paso nevertheless contends that these three companies should be treated as comparable in risk to it, because their combined natural gas and oil transmission business, including the transportation of oil, natural gas liquids, and petroleum products in addition to the transportation of natural gas, exceeds 50 percent of their total business. El Paso states that its witness, Dr. Vilbert, testified that the primary difference between interstate natural gas pipelines and oil pipelines is that the Commission regulates natural gas pipelines as contract carriers, while it regulates oil pipelines as common carriers. That means that natural gas pipelines provide service pursuant to either long-term or short-term contracts, while oil pipelines historically have sold capacity on a day to day basis.[376] While historically this difference has been considered to render oil pipelines somewhat more risky than natural gas pipelines,[377] Dr. Vilbert testified that recent developments have rendered this difference less significant. Among other things, he testified that the average length of natural gas pipeline contracts has decreased, with El Paso's average contract length less than three years, and the Commission has authorized oil pipelines to sell 90 percent of their new capacity under firm long-term contracts.

238. El Paso further states that the Commission recognized in Opinion No. 486-B[378] that oil transportation is "generally comparable"[379] to natural gas transportation, and therefore the Commission included KMEP in the proxy group in that case, finding that its natural gas and oil transportation business exceeded 50 percent of its total business and that the weight of its natural gas and oil business was similar, comprised of 35 percent natural gas transmission, 35 percent oil transmission and 30 percent other. El Paso claims that the record in this case shows KMEP has a similar asset distribution, with 39 percent natural gas pipeline assets, 31 percent oil pipeline assets, and 29 percent other. El Paso concludes that based on that evidence showing KMEP has over 70 percent of its assets devoted to oil and natural gas transmission, and the evidence demonstrating that KMEP has a strong position in transporting oil and other products in the same areas served by El Paso, it qualifies for inclusion in the proxy group under the criteria applied in Opinion No. 486-B. El Paso asserts that for similar reasons ONEOK and Enterprise should be included in the proxy group.

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[376] Ex. EPG-179 at 18.

[377] Opinion No. 486-B, 126 FERC ¶ 61,034 at P 73.

[378] *Id.* P 73.

[379] *Id*. P 141.

239. While the Commission may consider companies whose combined natural gas and oil pipeline business exceeds 50 percent for inclusion in a proxy group when necessary to achieve a proxy group of at least five companies, El Paso has not shown that the two businesses are so similar that such companies should be included in the proxy group, when, as here, five companies with a greater proportion of natural gas pipeline business are available for the proxy group. As El Paso has recognized, there are relevant differences in the manner in which the natural gas and oil pipelines are regulated. Moreover, when Dr. Vilbert was requested to supply all studies, articles, or credit rating reports which suggest that investors consider the two businesses to have similar risk, he was unable to do so.[380] El Paso's contention that investors would consider investments in KMEP, Enterprise and ONEOK, with their higher proportion of oil transportation business, as essentially the same as an investment in a company with a higher proportion of natural gas transportation business is also undercut by the fact that the ROEs resulting from the DCF analysis of these entities are at least 50, and as much as 100, basis points higher than the proxy group members approved by the Commission.[381]

240. While the Commission included KMEP in the proxy group in Opinion No. 486-B in order to establish a proxy group with at least five members, the Commission rejected KMEP as a proxy member group in Opinion No. 510, where the circumstances were similar to the instant facts. There, the Commission had adopted a proxy group of five members that met the Commission's threshold test, and thus declined to include KMEP and other non-interstate pipeline MLPs:

> Because we are approving a proxy group that includes five members that meet the threshold, we agree with the ALJ that these MLPs, including KMEP, which hold significant assets that are not related to the interstate transportation of [natural] gas, were appropriately excluded from the proxy group.[382]

In this case, El Paso's own evidence shows that KMEP has only approximately 39 percent of its assets devoted to interstate natural gas pipelines, 31 percent devoted to oil pipelines, and 29 percent to terminals and others.[383] Moreover, while KMEP may

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[380] Ex. S-10 at 46 and Ex, S-12 at 81.

[381] *See* Ex. S-11, Schedule 13 (showing that the ROE range for those three companies is 11.63 to 12.41 percent, while the range for the approved proxy group is 10.41 to 11.08 percent).

[382] Opinion No. 510, 134 FERC ¶ 61,129 at P 219.

[383] El Paso Rehearing at 58; *see also* Ex. EPG-181, p. B-4 of 5.

devote approximately 39 percent of its assets to natural gas pipeline business, that figure includes both interstate and intrastate pipelines.[384] Thus, not even all of KMEP's 39 percent pipeline ownership qualifies as interstate natural gas pipeline business for purposes of the 50 percent test, and El Paso provides no evidence to demonstrate KMEP's actual percentage ownership of interstate natural gas pipelines. In Opinion No. 510, we found that KMEP's ownership of significant assets devoted to the intrastate transportation of natural gas also raised concerns as to whether it was of comparable risk to the filing pipeline, because of differences between interstate and intrastate natural gas transportation. As we noted in *Portland*, "the more a firm's business profile diverges from the minimum 50 percent transmission rule, the more the Commission will have to make increasingly difficult determinations as to whether investors would view the non-transmission components of the firm's business as having comparable risk to its transmission components."[385] Here, not only does KMEP have only 39 percent of its assets devoted to natural gas pipeline transportation, the record lacks evidence as to the amount of those assets that are regulated by the Commission under the NGA. Thus, because the companies the Presiding Judge selected for the proxy group all met, or most nearly met, the 50 percent threshold test, there is no need to proceed to a second step to try to include companies that do not meet that test on their face.

241. With respect to the other two companies proposed by El Paso, the record shows that neither of those companies comes close to satisfying the 50 percent standard. Contrary to El Paso's claims that Enterprise and ONEOK have at least 25 percent of their assets or income devoted to FERC-regulated natural gas pipeline operations and 50 percent of their assets devoted to natural gas, oil, natural gas liquids (NGL) or petroleum products transmission, record evidence indicates that neither company meets that standard. As for Enterprise, its 2010 FERC Form No. 2 data shows that 0.56 (less than one) percent of its total assets consist of FERC-regulated interstate natural gas pipelines.[386] Further, El Paso's witness Vilbert acknowledged that in calculating the percentage of Enterprise's assets devoted to FERC-regulated natural gas transportation, he included in his analysis oil pipelines, jurisdictional gathering and storage assets, as well as non-jurisdictional natural gas gathering and intrastate pipeline facilities.[387] Thus El Paso did not show that Enterprise meets even El Paso's proposed test. Given the

[384] Ex. S-12 at 49 & n.1.

[385] Opinion No. 510, 134 FERC ¶ 61,129 at P 215.

[386] Ex. S-12 at 46.

[387] Ex. EPG-179 at 30 & n.43; *see also* Ex. EPG-179 at 47.

extremely low percentage of interstate natural gas assets owned by Enterprise, it seems reasonable that no investor would view Enterprise as risk comparable to El Paso.

242. El Paso also failed to show that ONEOK is risk appropriate. The record shows that only about 17 percent of ONEOK assets are devoted to, and only about 19 percent of its income is derived from, interstate natural gas pipeline operations.[388] Additionally, approximately 76 percent of ONEOK's assets are devoted to midstream operations, including NGLs and non-jurisdictional gathering and processing.[389]

243. As we noted in Opinion No. 510, companies like Enterprise and ONEOK "own significant assets that are devoted to the transportation of natural gas liquids, gathering, processing, and other non-interstate natural gas transportation operations."[390] Here, as in that case, El Paso has failed to show that these non-jurisdictional activities have risk levels similar to that of interstate natural gas pipelines. Based on the very low percentage of interstate natural gas pipeline transportation assets owned by these companies, it is reasonable to conclude that they do not face risk commensurate with that of interstate natural gas pipelines (including El Paso), and were properly excluded from the proxy group in this proceeding.

244. Further, El Paso's claim that it was not reasonable to relax the standard to include Williams but to refuse to do so to allow the inclusion of its three proposed companies lacks merit. El Paso complains that the Presiding Judge and the Commission rejected KMEP, ONEOK and Enterprise solely on the basis that they did not meet the 50 percent test and failed to perform the required risk analysis. As discussed above, however, the rejection of the companies proposed by El Paso was made after a thorough analysis to establish a five-member proxy group that met, or most nearly met, all the criteria, including the 50 percent test. We find it was reasonable to relax the standard to allow the inclusion of a company that was less than three percent shy of the 50 percent test to bring the proxy group to the required five members, and to then exclude the additional companies proposed by El Paso, which as discussed above did not come close to meeting the 50 percent test and are not risk comparable to El Paso for the purposes of this proceeding.

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[388] Ex. S-12 at 52. While El Paso contends that 24 percent of ONEOK's assets are devoted to gas pipelines (Ex. EPG-181, B4 of 5), that figure is still far below the 50 percent requirement.

[389] Ex. EPG-179 at 47.

[390] Opinion No. 510, 134 FERC ¶ 61,129 at P 220.

245. Finally, El Paso argues that the Commission erred in Opinion No. 528 by ignoring the argument that establishing a larger proxy group is statistically more reliable.[391] El Paso contends that the Commission in Opinion No. 486-B recognized that a larger proxy group sample leads to more reliable ROE results. El Paso states that the Commission ignored Dr. Vilbert's testimony that the unsettled economic conditions during the test period require the adoption of an expanded proxy group sample in order to produce reliable results under the two-step DCF model. El Paso further claims that the need for an expanded proxy group is even greater here because of the overlapping ownership of Spectra Corporation and Spectra Partners. El Paso asserts that the Commission erred by ignoring El Paso's argument that a larger sample group would beneficially increase the reliability of the two-step DCF results given the (1) homogeneity between oil and natural gas pipeline operations, (2) the overlap of two of the five proxy group companies and (3) the potentially distorting impact of the financial crisis. El Paso thus concludes that it was arbitrary and capricious to reject the inclusion of the three additional companies in the proxy group.

246. We reject El Paso's argument on this point. As we noted in Opinion No. 528, while a larger proxy group may be more desirable from a statistical standpoint, that is only the case if the additional entities are comparable in risk to the subject company.[392] As demonstrated above, that has not been shown to be the case here. In these circumstances, adding KMEP, ONEOK, and Enterprise to the proxy group would unreasonably dilute the influence of the more clearly comparable companies we have included in the proxy group in determining El Paso's ROE.

247. Accordingly, we reaffirm our holding in Opinion No. 528 that the risk appropriate proxy group for determining El Paso's ROE consists of Boardwalk, Spectra Corporation, Spectra Partners, TC Pipelines, and Williams.

2. <u>Discounted Cash Flow (DCF) Analysis</u>

248. As noted above and in Opinion No. 528, once a risk appropriate proxy group is selected, the Commission performs a two-step DCF analysis of the publicly-traded proxy firms to determine the return the equity markets require a pipeline to give its investors in order for them to invest their capital in the pipeline. The two-step DCF model 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

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[391] El Paso Rehearing at 62-64.

[392] Opinion No. 528, 145 FERC ¶ 61,040 at P 624.

with the stock's risk.[393] With simplifying assumptions, the formula for the DCF model reduces to:

> P = D/ (k-g), where "P" is the price of the stock, "D" is the indicated dividend rate, "k" is the rate at which future cash flows must be discounted to equate them to present value, and "g" is the estimated constant growth in dividend income to be reflected in capital appreciation.

249. 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:

> k = D/P + g, where "k" is the cost of equity, "D/P" is the current dividend yield (dividends divided by stock price), and "g" is the expected growth rate in dividends.[394]

250. To reflect the quarterly payment of dividends, the dividend yield is multiplied by (1 + 0.5 g).[395] Therefore, the Commission's two-step DCF formula becomes: k = D/P (1 + 0.5 g) + g. The DCF model assumes that the sum of the adjusted dividend yield and the growth rate is equivalent to the company's cost of equity.

251. 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 for both corporations and MLPs, 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 expected, long-term growth of the economy as a whole.[396] However, the Commission has held that the long-term growth rate for MLPs

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[393] *CAPP v. FERC*, 254 F.3d 289, 293.

[394] *National Fuel*, 51 FERC ¶ 61,122 at 61,337 n.68; *Ozark Gas Transmission Sys.*, 68 FERC ¶ 61,032, at 61,104 n.16 (1994).

[395] *See, e.g., Trunkline Gas Co.,* Opinion No. 441, 90 FERC ¶ 61,017, at 61,112 (2000).

[396] *Northwest Pipeline Corp.*, Opinion No. 396-B, 79 FERC ¶ 61,309, at 62,383 (1997); *Williston Basin Interstate Pipeline Co.*, 79 FERC ¶ 61,311 at 62,389 (1997); *aff'd in relevant part, Williston Basin Interstate Pipeline v. FERC*, 165 F.3d 54 at 57 (1999) (*Williston v. FERC*).

should be 50 percent of long-term growth in GDP, because they distribute virtually all their earnings to their limited partners.[397] 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.[398]

252. The only issue raised on rehearing of Opinion No. 528 concerning the two-step DCF analysis of the proxy group members relates to the long-term growth projection of the MLPs in the proxy group, Boardwalk, TC Pipelines, Spectra Partners, and Williams. As described in the Proxy Group Policy Statement,[399] MLPs consist of a general partner, who manages the partnership, and limited partners, who provide capital and receive cash distributions, but have no management role. The units of the limited partners are traded on public exchanges, just like stock shares, but there is generally no similar trading of the general partner interest or the MLP as a whole. At their inception, MLPs establish agreements between the general and limited partners, which define cash flow available for distribution and how that cash flow is to be divided between the general and limited partners. Most MLP agreements define available cash flow as (1) net income (gross revenues minus operating expenses) plus (2) depreciation and amortization,[400] minus (3) capital investment the partnership must make to maintain its current asset base and cash flow stream. In addition, MLP agreements generally give the general partners Incentive Distribution Rights (IDRs), which provide for them to receive increasingly higher percentages of the overall distribution, if the general partners are able to increase that distribution above defined levels.

253. In both the Proxy Group Policy Statement and Opinion No. 486-B,[401] the Commission held that the long-term growth projection for MLPs should be only

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[397] Proxy Group Policy Statement, 123 FERC ¶ 61,048 at PP 88-106. *Kern River*, Opinion No. 486-B, 126 FERC ¶ 61,034 at PP 124-130.

[398] *Transcontinental Gas Pipe Line Corp.*, Opinion No. 414, 80 FERC ¶ 61,157 (1997), Opinion No. 414-A, 84 FERC ¶ 61,084, at 61,423-24, *order on reh'g*, Opinion No. 414-B, 85 FERC ¶ 61,323, at 62,266-70 (1998), *aff'd sub nom. North Carolina Utilities Comm'n v. FERC*, 203 F.3d 53 (D.C. Cir. 2000) (unpublished opinion). Cited with approval in *CAPP v. FERC*, 254 F.3d 289, 298.

[399] Proxy Group Policy Statement, 123 FERC ¶ 61,048 at PP 10-13.

[400] Depreciation and amortization may be considered part of cash flow, because depreciation is an accounting charge against current income, rather than an actual cash expense.

[401] *Kern River*, Opinion No. 486-B, 126 FERC ¶ 61,034 at PP 124-130.

50 percent of long-term GDP projected growth, because MLPs, unlike corporations, do not retain significant earnings to finance growth because they distribute most available cash flow to the partners in the form of quarterly dividends. In the *Policy Statement*,[402] the Commission also held that the two-step DCF analysis of an MLP should be based solely on data for the limited partner units, including a dividend yield calculated using the stock price for the limited partner units. The Commission rejected a proposal by INGAA to perform the two-step DCF analysis for the MLP as a whole, including the interests of both the limited and the general partners. INGAA stated that this could be done pursuant to a "Benchmark Model" developed by its witness, Mr. Michael J. Vilbert. The Benchmark Model assumes that, as a result of the general partner's incentive distribution rights, a two-step 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 general partner interests than the MLP units which would, in turn, reduce the general partner's current "dividend" yield. However, since there are relatively few publicly traded general partner interests, the Benchmark Model derived an estimated cost of equity capital for the general partner through various assumptions that mark up the limited partner's cost of equity capital.

254. In the Proxy Group Policy Statement, the Commission decided not to use the Benchmark Model for two reasons. First, the Commission found that the internal operations of the model were relatively opaque, and the model appeared to have a relatively wide range of error. Second, the Commission found that, because the general partner interest is generally not publicly traded, its inclusion in the Benchmark Model is inconsistent with the purpose of a proxy group to "provide market-determined stock and dividend figures from public companies comparable to a target company for which those figures are unavailable."[403] The Commission stated the requisite market-determined data does not exist for the general partner interest, because that interest is generally not publicly traded.

<u>Opinion No. 528</u>

255. In this rate case, El Paso proposed to use Dr. Vilbert's Benchmark Model to perform a two-step DCF analysis of the MLPs chosen for the proxy group. In Opinion No. 528, the Commission affirmed the Presiding Judge's rejection of the Benchmark Model, and instead based its two-step DCF analysis on data for the limited partner interests only. The Commission also found that in accordance with the Proxy Group

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[402] Proxy Group Policy Statement, 123 FERC ¶ 61,048 at P 104.

[403] *Id.* (quoting *Petal Gas v. FERC*, 496 F.3d 695 at 699).

Policy Statement, it was reasonable to adhere to the use of 50 percent of a GDP forecast as the long-term growth estimate for MLPs in the two-step DCF analysis.[404]

256. The Commission found the Benchmark Model to be inconsistent with the Commission's two-step DCF analysis and deficient in several ways. First, the Commission noted that the proposed model attempts to estimate the cost of equity capital for the MLP as a whole, including both the general and limited partners' interests, contrary to the Proxy Group Policy Statement's finding that the analysis should only consider the publicly traded limited partner's interest. The Commission stated that the use of the general partner interest, which is not publicly traded, would be inconsistent with the "purpose of the proxy group of providing a fully market-based estimate of cost of capital…."[405]

257. Second, the Commission also found that the "Benchmark Model" deviated from the Commission-approved two-step DCF analysis in several critical ways, following the Policy Statement.[406] The Commission stated that the model's internal operations, lack of transparency and reliance on calculated market data made it unreliable.[407] The Commission stated that because only the limited partner interest of an MLP is publicly traded in capital markets, and investment analysts only make five-year projections for those interests, El Paso's witness had to engage in a separate questionable analysis to develop implied market prices, dividends and earnings projections. The Commission found that such an approach was inconsistent with the purpose of a proxy group, i.e., to "provide market-determined stock and dividend figures from public companies comparable to a target company for which these figures are unavailable."[408]

258. The Commission also noted that several of the assumptions upon which the model relies may not be reasonable. The first questionable assumption is that the Benchmark Model produces the most appropriate estimate of the cost of equity for use in the two-step DCF analysis because it includes the general and limited partner interests. The Commission found this assumption to be questionable based on its use of only publicly traded common stock for the DCF analysis of corporations. The Commission also

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[404] Opinion No. 528, 145 FERC ¶ 61,040 at P 656.

[405] *Id.* P 644.

[406] *Id.* P 646.

[407] *Id.* PP 645-648.

[408] *Id.* P 648 (citing *Petal Gas v. FERC*, 496 F.3d 695, 699).

questioned the need to know the cost of equity of the general partner given that MLPs, like corporations, finance their growth through the sale of publicly traded interests. Finally, the Commission noted that the purpose of the DCF analysis is to develop a cost of equity that represents an opportunity cost in terms of reflecting the opportunity to invest in alternative investments of comparable risk. The Commission found that the Benchmark Model fails from this standpoint because there is no opportunity for an investor to invest in the general partner interest of an MLP.[409]

259. Accordingly, Opinion No. 528 affirmed the Presiding Judge's adoption of Trial Staff's two-step DCF analysis of the proxy group, which used a long-term growth projection for each MLP equal to 50 percent of projected growth in GDP. Under that DCF analysis, the cost of equity estimates of each proxy firm are: Spectra Corporation: 11.08 percent; TC Pipelines: 10.89 percent; Williams: 10.55 percent; Boardwalk: 10.41 percent; and Spectra Partners: 10.39 percent.[410] Thus, the range of reasonableness is 10.39 percent to 11.08 percent, with a median of 10.55 percent.

Request for Rehearing

260. On rehearing, El Paso argues that there is no record evidence or reasoning to support the long-term growth rate of MLPs at 50 percent of GDP. El Paso claims that while the Commission found in the Proxy Group Policy Statement that the long-term growth rates for MLPs will be less than those of corporations, the Commission also acknowledged that long-term growth estimates are difficult to make and that the Commission was thus required to choose among imperfect alternatives. El Paso claims, however, that the Commission's determination in the Policy Statement to use 50 percent of GDP to measure long-term growth was supported only by the assertion that one-half the GDP was within the range of long-term growth projections for individual MLPs used by investment houses, and that the Commission relied on the projections of only one such firm. Thus, according to El Paso, a 50 percent reduction in GDP is arbitrary and lacks support in financial theory.

261. El Paso claims that given the lack of supporting evidence for its use of 50 percent of GDP to measure the long-term growth of MLPs, the Commission must adopt a different method. El Paso contends that the Commission should have adopted the Benchmark Model because it is purportedly premised on sound financial theory, and was largely unchallenged in this proceeding. El Paso contends that even if the Commission

[409] *Id.* P 651.

[410] Ex. S-11, Schedule 11.

declines to adopt the Benchmark Model, it should use a long term growth rate equal to full GDP, which produces a result similar to that achieved by the Benchmark Model.

Commission Determination

262. Contrary to El Paso's claims, the burden of proof in this proceeding is on El Paso to show that its proposed methodology for calculating the long-term growth of MLPs for purposes of the Commission's two-step DCF analysis is just and reasonable. In this NGA section 4 rate case, El Paso has proposed a substantial rate increase. NGA section 4(e) provides that the pipeline has "the burden of proof to show that the increased rate or charge is just and reasonable." El Paso's proposed ROE is an element of its overall rate increase proposal. Therefore, El Paso has the burden of proving that its proposed ROE, including its use of the Benchmark Model for its DCF analysis of the MLPs in the proxy group, is just and reasonable.[411]

263. As described above, MLPs, unlike corporations, generally distribute most available cash flow to the general and limited partners.[412] In both the Proxy Group Policy Statement[413] and Opinion No. 486-B[414] applying the Policy Statement to Kern River, the Commission found that this intrinsic difference between MLPs and corporations causes MLPs to have a lower long-term, or terminal, growth rate than corporations in the same business. While corporations may finance growth through internally-generated retained earnings, MLPs must continuously access debt and equity markets to finance growth. If MLPs were unable to access these markets or could not access them on favorable terms, this could inhibit long-term growth in their distributions.[415] In Opinion No. 486-B, the Commission found that the record in that litigated proceeding confirmed that investors expect MLPs as a class to have lower long-term growth rates than the GDP growth projection used for corporations. The

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[411] *Williston Basin Interstate Pipeline Co*., 87 FERC ¶ 61,264, at 62,004 (1999) ("Quite simply, since Williston filed pursuant to NGA section 4 to increase its rates, it has the burden under NGA section 4 of supporting each element of its increased cost-of-service, including its proposed return on equity.").

[412] *See* Proxy Group Policy Statement, 123 FERC ¶ 61,068 at P 12.

[413] *Id*. PP 92-94.

[414] Opinion No. 486-B, 126 FERC ¶ 61,034 at PP 127-128.

[415] *Id*. P 127 n.196 (citing Wachovia Securities, Master Limited Partnerships: A Primer (Wachovia MLP Primer)).

Commission cited exhibits showing that Wachovia's growth projections for MLPs averaged 2.63 percent for 2004, Merrill Lynch assigned a terminal growth rate of 1 percent to all MLPs, and Citigroup's long-term growth projections were 1 percent for Enterprise, zero percent for KMEP, and .5 percent for ONEOK.[416] All these growth projections were substantially less than the long-term GDP growth projection of 5.36 percent at the time of that proceeding.

264. In this case, El Paso recognizes that the terminal growth rate of an MLP's limited partner interest may be less than the long-term growth in GDP. However, it contends that the DCF analysis of an MLP should be based on the MLP as a whole, including the interest of its general partner, as well as the interest of the limited partners. For this purpose, El Paso presented testimony of its expert witness, Dr. Vilbert, setting forth his "Benchmark Model" for performing a two-step DCF analysis of an MLP as a whole.

265. The Benchmark Model proposed by Dr. Vilbert estimates the cost of equity capital of each MLP as a whole, inclusive of both the general and the limited partner interests.[417] Dr. Vilbert asserts that the general partner interest is typically more risky than the limited partner interest and therefore the cost of limited partner equity will tend to underestimate the true weighted cost of equity for the MLP as whole. Dr. Vilbert explains that, when an MLP is formed, its general partner interest is initially more risky than the limited partner interest, because of the structure of general partner's Incentive Distribution Rights. Typically, the agreement between the general partner and the limited partners provides that the MLP will make virtually all of its distributions (for example 98 percent) to its limited partners until the MLP's total distributions reach a defined amount, after which the general partner receives increasingly higher percentages of the overall distribution, if the MLP is able to increase its total distributions above defined levels.[418] Typically, the general partner's maximum share of the MLP's total distributions is 50 percent. Dr. Vilbert contends that this means that variations in earnings (and distributions) are initially greater for the general partner, than for the limited partner units, making the general partner interest more risky. However, as total distributions increase, some risk is transferred to the limited partner units, because the variability of distributions to the general partner decreases, reducing its risks from the initial level.

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[416] *Id*. P 126. Opinion No. 436-B found the Wachovia growth projections, which were only slightly less than one-half of GDP, to be more consistent with other evidence in the record than the other, lower GDP growth projections. *Id*. P 128.

[417] El Paso Rehearing at 71-72 (citing Ex. EPG-179 at 37-39).

[418] Ex. EPG-179 at 37.

266. As Dr. Vilbert recognizes, performing a two-step DCF analysis of an MLP as a whole is complicated by the fact that there are no short-term growth projections or stock prices for the MLP as whole. Generally, investment analysts make growth forecasts only for the limited partner interest, and only the limited partner interest is publicly traded. Therefore, in order to perform a DCF analysis of each MLP in the proxy group as a whole, Dr. Vilbert used what he calls his "Benchmark Model." Because growth rates and prices related to the MLP as a whole are not available, the Benchmark Model must rely on calculations to derive those figures from the limited partner growth rates and unit prices.[419] The Benchmark Model thus uses the IBES five-year growth projections and stock prices for the limited partner interests of each MLP as the starting point for deriving corresponding growth projections and stock prices for each MLP as a whole.[420] Accordingly, the Benchmark Model relies on assumptions and not actual market data to calculate estimated returns for MLPs.

267. Dr. Vilbert calculated his short-term growth projections by determining the five-year growth in each MLP's total distributions that would be required in order for it to make the distributions to limited partners projected by IBES, taking into account the increasing percentages of the total distribution to which the general partner would be entitled pursuant to its Incentive Distribution Rights.[421] This resulted in somewhat higher short-term growth projections for the MLP as a whole, than the actual IBES growth projections for the limited partner interest.

268. Dr. Vilbert also assumed that the stock price for the MLP as a whole should be higher than the stock price for the limited partner interest, because the general partner interest is more risky. Dr. Vilbert estimated a lower bound for the increased stock price based upon his estimate of the general partner's percentage share of the MLP's distribution over the next five years. Because that share was relatively small for the MLPs in the proxy group, that calculation led to a relatively small increase in the estimated low stock price for each MLP as whole over the actual price of the limited partner units.[422] Dr. Vilbert estimated an upper bound for the increased stock price based

[419] Vilbert Testimony, Ex. EPG-179 at 37-39.

[420] *Id.* at 36- 37.

[421] *See* Ex. EPG-179 at 37-38 (describing Dr. Vilbert's method of calculating a short-term growth projection for the overall MLP).

[422] For example, Dr. Vilbert estimated that Boardwalk's general partner would receive only 7 percent of its total distributions over the first five years, and based on this figure his estimate of a low stock price for the MLP as a whole was $31.59, only slightly higher than the $29.37 actual price for a limited partner unit. Ex. EPG-179 at 17.

on the general partner's maximum percentage of the MLP's total distributions, which in all cases is 50 percent. Based on that sharing percentage, Dr. Vilbert estimated that the upper bound of the stock price for the MLP as whole was twice the current price of a limited partner unit. For all the proxy group MLPs, there was a wide variation between Dr. Vilbert's estimated low and high stock prices for the MLP as whole.[423] Dr. Vilbert averaged his high and low stock price estimates to obtain the stock prices he used in his two-step DCF analysis of each of these MLPs.

269. Once Dr. Vilbert determined a five-year short-term growth projection and current stock price for each MLP as a whole, he then performed a multi-stage DCF analysis of each MLP, rather than the constant growth, two-step DCF analysis used by the Commission. For this purpose, he assumed that each MLP would grow at its estimated five-year growth rate for the first five years, that growth would then decrease (or increase) at a uniform rate over the next 10 years equal to the projected long-term growth in GDP, which would then continue indefinitely.[424] Dr. Vilbert testified that he used the full estimated growth in GDP as the terminal growth rate for the MLP as a whole, "because for the MLP, terminal growth is not likely to differ from that of an otherwise identical corporation; in other words, organizational structure is unlikely to affect the terminal growth rate at the entity level."[425]

270. The Commission finds that El Paso has failed to satisfy its burden of justifying use of its Benchmark Model for purposes of determining the cost of equity estimates of the four MLP members of the proxy group. As the Commission stated in Opinion No. 528, the United States Court of Appeals for the District of Columbia has held 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 those figures are unavailable."[426] However, the general partner interests of the proxy group MLPs are not publicly traded, nor are the MLPs as a whole publicly traded. Therefore, in order to perform a two-step DCF analysis of each MLP as a whole, Dr. Vilbert was forced to impute a stock price for each MLP for use in calculating its dividend yield. However, as

[423] Dr. Vilbert's estimated low and high stock prices were as follows: Boardwalk: $31.59 and $58.73; Spectra Partners: $32.69 and $62.31; TC Pipelines: $44.01 and $75.86; and Williams Partners: $50.60 and $79.82. Ex. EPG-179 at 17-20.

[424] Ex. EPG-179 at 38-39.

[425] *Id*. at 39.

[426] Policy Statement, 123 FERC ¶ 61,048 at P 104 (quoting *Petal Gas v. FERC*, 496 F.3d 695 at 699).

described above, Dr. Vilbert's method of imputing a stock price was very inexact, producing high estimates which in all cases are more than 50 percent higher that his low estimates and then simply averaging the two estimates. Moreover, he assumed that the only relevant factor for determining how an investor would view the value of the MLP as a whole, as compared to the limited partner interest, is the general partner's Incentive Distribution Rights. However, it is reasonable to assume that other factors would influence an investor's assessment of the value of the MLP as a whole, such as general partner's control over the operations of the MLP.[427] Given the crucial role of stock prices in estimating an entity's cost of equity capital pursuant to the two-step DCF methodology, the Commission finds that the Benchmark Model is fatally flawed by the lack of any method for producing a reasonably exact estimate of a stock price for an MLP as whole.

271. Moreover, Dr. Vilbert has not supported his assumption that the terminal growth rate for an MLP as a whole should be the same as a corporation, i.e. projected long-term growth in GDP. Dr. Vilbert's only support for that assumption is his assertion that "organizational structure is unlikely to affect the terminal growth rate at the entity level." However, the reasons the Commission has relied upon to find that MLPs are likely to have lower long-term growth than corporations are applicable to the MLP as a whole, not just the limited partner interest. As discussed in the Proxy Group Policy Statement, MLPs generally distribute most available cash flow to the general and limited partners in the form of quarterly distributions.[428] As Dr. Vilbert's own testimony in this proceeding recognizes, "because of the requirement that a MLP must distribute substantially all of its free cash-flow, the MLP must rely more heavily on external financing to grow than its corporate counterpart. The MLP finances growth by going to the market for capital to fund projects, whereas a C-corporation can rely, in part, on retained earnings."[429]

272. In the Proxy Group Policy Statement[430] and Opinion No. 486-B, the Commission found that this difference between MLPs and corporations causes the MLPs to have

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[427] Further, Dr. Vilbert's assumption that the overall MLP should have a higher stock price because the general partner's interest is riskier defies logic as it is opposed to accepted financial theory. In the basic DCF equation, $P = D / (k – g)$, a higher value for "k" would result in a lower value for "P", all else being equal. Given that investors demand higher returns as risk increases, the stock price should be lower for the general partner's interest since it is riskier than the limited partners' interests.

[428] Policy Statement, 123 FERC ¶ 61,048 at P 11.

[429] Ex. EPS-179 at 22.

[430] 123 FERC ¶ 61,048 at PP 92-94.

lower long-term growth prospects than corporations.[431] Among other things, the Commission explained in those orders that the greater need to access debt markets to finance growth subjects MLPs to greater interest rate risk than corporations. A June 10, 2011 Value Line report on MLPs included in the record in this proceeding makes the same point. Under the heading "Interest Rates Remain a Concern," that report states that "MLPs generally fund growth by issuing debt and equity," and low interest rates have allowed MLPs to fund their growth quite cheaply.[432] However, the same report states, "Should rates rise, most partnerships will likely elect to roll their shorter term borrowings into long-term debt. Thus, higher rates would cause MLPs to pay more to fund their expansions, and would result in higher-yielding – and relatively risk-free – securities competing with MLPs for the attention of income investors."[433] Also, there are limits to how much debt an MLP can issue, without increasing its debt to equity ratio to a level that would be unattractive to investors.

273. In addition, as Dr. Vilbert recognizes, an MLP's other option for financing growth – the issuance of additional equity – inhibits the MLP's ability to increase its earnings per share. As Dr. Vilbert explained, "the increased need to go to the market for capital ultimately implies a higher growth in the number of shares/units outstanding for a MLP than for a C-corporation. Even if the two organizations as a whole are growing at the same rate (in long-run equilibrium), a higher rate of growth in outstanding shares for the MLP means that earnings per LP unit must grow at a slightly lower rate compared to the C-corporation. How much less, however, is uncertain."[434] While Dr. Vilbert sought to minimize this impediment to growth in earnings per share, the fact remains that any issuance of additional limited partner units by an MLP to fund pipeline expansions would require the MLP's distributions to be spread over more units of equity ownership. This would inevitably dilute any growth in earnings per equity unit for the MLP as a whole, not just the limited partner interest.[435]

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[431] *See* Opinion No. 486-B, 126 FERC ¶ 61,034 at P 110.

[432] Ex. S-12 at 9.

[433] *Id*.

[434] Ex. EPG-179 at 22.

[435] Dr. Vilbert's Benchmark Model does not consider what percentage of the MLP's overall equity investment is made by the general partner, as opposed to the limited partners. However, the first page of the Wachovia MLP Primer, cited in both the Policy Statement and Opinion No. 486-B, states that the general partner generally has only a two percent ownership stake in an MLP. Assuming this to be true, the dilution in

(continued...)

274. By contrast, a corporation, unlike an MLP, can use the cash from its retained earnings to finance growth internally. This gives a corporation significantly more flexibility in how it finances growth. Investing the cash from its retained earnings in new pipeline projects does not increase outstanding shares for the MLP, with the result that existing shareholders receive the entire benefit of any increase in the MLP's earnings. Also, use of cash from its retained earnings reduces the need to issue additional debt, so that the corporation can maintain a more attractive debt to equity ratio while engaged in pipeline expansion projects intended to increase earnings.

275. For these reasons, it is a well-established economic theory that a company that retains less earnings will grow at a slower rate than one that retains more earnings. Given that the organizational structure of an MLP requires that it distribute essentially all of its earnings to its general and limited partners, it follows under this theory that MLPs will grow in the long-term at a slower rate than corporations, which are not required to distribute all their earnings. Trial Staff's witness supported this conclusion at the hearing, testifying, "the reason for the lower growth is simply that most MLPs pay a level of dividends that's equal to or near their level of earnings. Therefore, the largest component of growth for most companies [which] would be the retention ratio is almost nonexistent for MLPs. So they have to aggressively make acquisitions in order to get their growth. It's reasonable to assume it would be less than for corporations that actually do have retained earnings, and [by] a large percentage."[436] It was incumbent upon El Paso, therefore, the party attempting to discredit the theory that high pay-out rates reduce growth, to provide evidence to the contrary. Instead, as noted above, El Paso simply assumed, as part of its Benchmark Model, that "organizational structure is unlikely to affect the terminal growth rate at the entity level." The Commission accordingly finds that El Paso failed to support the assumption, incorporated into the Benchmark Model, that an MLP as a whole can be assumed to have long-term growth prospects equal to those of a corporation.

276. A further flaw in the Benchmark Model is its use of a multi-stage DCF analysis, rather than the two-step constant growth analysis used by the Commission. While the Commission recognizes that many financial analysts and investment houses use multi-

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earnings per equity unit from an MLP's issuance of new limited partner units would be essentially the same for the MLP as a whole as for the limited partner interest. Dr. Vilbert's failure to present evidence as to the general and limited partners' relative shares of equity ownership, or to address how such relative ownership levels might affect the two-step DCF analysis of the MLP as a whole, is a further flaw in El Paso's support for the Benchmark Model.

[436] Tr. at 4695-96.

stage DCF analyses, the Commission has not adopted this approach "because the calculations are more involved and require attempts to predict the future that 'are not well suited to litigation where the witness for each party is likely to choose from among reasonable alternatives, those data and methodologies that most favor his or her client's financial interest and there are no objective criteria for the Commission to make distinctions between what will be the equally well-reasoned and well-supported judgements of the equally well-credentialed experts.'"[437] Here, Dr. Vilbert stated he made "assumptions on the path of this growth rate over time. I assume a flat period of 5 years and a linear trending period of 10 years, at the end of which the growth rate has decreased or increased to the forecasted terminal long-run GDP growth rate."[438] Dr. Vilbert provides no other support for his assumption that the second growth stage will last 10 years, thus illustrating the primary reason the Commission has not adopted the multi-stage DCF method – the lack of objective criteria for determining the length of the different growth stages.

277. For all these reasons, the Commission finds that El Paso has failed to satisfy its burden of proving that the Benchmark Model is a just and reasonable method of determining the cost of equity estimates of MLPs included in the proxy group. In these circumstances, the two-step DCF analysis of the proxy group MLPs must be based on market-determined data for the limited partner units of those MLPs, consistent with the court's holding in *Petal Gas v. FERC* 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 those figures are unavailable."[439] Thus, the DCF analysis of each MLP must be based on the stock price of its limited partner units, the amount of its limited partner distributions, and its IBES growth projection. That leaves only the question of what long-term growth projection to use.

278. El Paso's witness Dr. Vilbert has conceded that the long-term growth of limited partner distributions will be less than growth in GDP. While he asserted that the long-term growth of an MLP as a whole may equal the growth in GDP, he testified that the terminal growth of the limited partner interest "is likely to fall short of the terminal rate for the MLP entity as a whole, because of the way in which MLPs finance their

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[437] *Williston Basin Interstate Pipeline Co.*, 81 FERC ¶ 61,033, at 61,176 (1997) (explaining that the determination of the Stage 2 growth rate requires a judgment by the analyst of the length of time Stage 2 will last and whether the growth will decline slowly, quickly, or at a steady rate).

[438] Ex. EPG-179 at 38-39.

[439] 496 F.3d 695 at 699.

operations."[440] In light of this concession, the Commission finds that the long-term growth projection for the limited partner interest must be less than long-term growth in GDP.[441]

279. In our only previous natural gas pipeline case where the issue of a long-term growth projection for MLPs was litigated, Opinion No. 486-B, we held that the reasonable long-term growth projection was 50 percent of GDP. As described above, the Commission arrived at that estimate based on evidence that three investment houses, Wachovia, Merrill Lynch, and Citigroup, projected terminal growth rates for MLPs at less than half of the growth in GDP. El Paso has not provided evidence that demonstrates adopting a long-term growth projection in excess of 50 percent of GDP for the limited partner interests of the MLPs in this case would be just and reasonable.

280. In its rehearing request, El Paso emphasizes that no party in this case presented evidence concerning what long-term growth projections investment houses are currently making for MLPs similar to the evidence cited by Opinion No. 486-B. El Paso also states that it is not clear from Opinion No. 486-B whether the low long-term growth projections cited in that opinion applied only to MLPs, or were simply conservative estimates plugged in for long-term growth in those analyses because long-term growth estimates are difficult to make for any entity. El Paso also points out that, at the January 23, 2008 technical conference held by the Commission before issuing the Policy Statement, a Wachovia analyst testified that its estimates of long-term growth were intended to be conservative parameters for its models. In addition, El Paso states that a January 28, 2008 report on the technical conference issued by Morgan Stanley Research North America stated, "[W]e assume that an MLP will increase its cash flow ~ 1.5 [percent] - 3.0 [percent] per year beyond 2012. Importantly, we make the same assumption in forecasting long-term growth for our C-Corp companies. Furthermore, analysts in other sectors stake a similar view on long-term growth ~1.5-3.0 [percent]. The rationale is to err on the side of conservatism versus making a statement about actual long-term growth."[442]

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[440] Ex. EPG-179 at 39.

[441] We also note that the IBES short-term growth projections for the four MLPs in the proxy group range from 4.5 percent to 6.07 percent, while the IBES growth projection for the one corporation in the proxy group is 8.27 percent. Ex. S-12 at 264-269. This suggests that, even over the near-term, investors see significantly greater growth prospects for a corporation than MLPs.

[442] Ex. EPG-179 at 24. The full Morgan Stanley report, entitled "Pipeline MLPs: What's in the Pipeline," was included in the February 11, 2008 post-technical conference

(continued...)

281. In the Proxy Group Policy Statement,[443] the Commission recognized that an investment house analyst had testified that investment houses use "conservative" estimates in order to prevent unrealistic investor expectations. However, the Commission found that it is appropriate for the Commission to use growth estimates that reflect the investment houses' view of what investors should realistically expect from an investment in an MLP. In addition, the Commission stated that it placed greater weight on the Citigroup and Wachovia publications for two reasons.[444] First, those publications included specific long-term growth projections for individual MLPs, whereas the Morgan Stanley publication simply set forth a general range that it uses without specifying how that range is distributed among individual firms. Second, the Citigroup and Wachovia analyses were not issued in response to the technical conference, whereas the Morgan Stanley publication was specifically a report on the technical conference. Thus, the focus of the Citigroup and Wachovia analyses was to provide advice to investors, while the Morgan Stanley publication appeared more in the nature of advocacy concerning the outcome of the technical conference.[445]

282. The hearing in the instant proceeding provided El Paso the opportunity to present additional evidence about investor expectations concerning the long-term growth prospects of MLPs. Despite that opportunity, El Paso did not submit any reports by investment houses or other investor advisory services concerning MLP growth, other than the Morgan Stanley report which was part of the record in the Docket No. PL07-2-000 proceeding leading to the Policy Statement and which the Commission found unpersuasive. Instead, El Paso focused on its contention that the Commission should perform a two-step DCF analysis of each MLP as a whole, using the Benchmark Model originally presented in the Docket No. PL07-2-000 proceeding. In the discussion above,

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comments of the National Association of Publicly Traded Partnerships in Docket No. PL07-2-000.

[443] 123 FERC ¶ 61,048 at P 90.

[444] *Id*. P 89 n.130. The Merrill Lynch publication assigning a terminal growth rate of 1 percent to all MLPs was not part of the Policy Statement technical conference record, but was only submitted in the Opinion No. 486-B proceeding.

[445] The Docket No. PL07-2-000 record also includes a June 2007 Value Line analysis stating that corporations in the Oil/Gas Distribution Industry "retain earnings to invest in new projects. That both raises their growth potential and lowers their stocks' yields vis-à-vis MLPs." February 11, 2008 initial comments of Public Service Commission of New York, Attachment 3 at 1.

after carefully considering Dr. Vilbert's testimony in this proceeding,[446] the Commission found El Paso has not satisfied its burden to show that use of the Benchmark Model is reasonable, and therefore the Commission found that it must base its DCF analysis of the MLPs in the proxy group on data for the limited partner interest. As discussed above, El Paso has conceded that the long-term growth of the limited partner interest will be less than the long-term growth in GDP.

283. In Opinion No 486-B, where the issue of MLPs' long-term growth was last litigated, the Commission adopted a long-term growth projection for the limited partner interest equal to 50 percent of long-term GDP growth.[447] That figure was slightly in excess of the highest MLP long-term growth projection used by any of the three investment houses whose projections were included in the record of that proceeding. El Paso has not submitted any evidence in this proceeding that would support a long-term growth projection for the limited partner interest in excess of the 50 percent of GDP figure adopted in Opinion No. 486-B.[448] In these circumstances, the Commission concludes that El Paso has failed to satisfy its burden under NGA section 4(e) to show that its proposed DCF analysis of the MLPs in the proxy group is just and reasonable.

284. Accordingly, we deny rehearing of Opinion No. 528's adoption of the Presiding Judge's decision to use the same two-step DCF methodology for the MLPs in the proxy group as used in Opinion No. 486-B, including projected long-term growth equal to 50 percent of long-term growth in GDP. We therefore affirm Opinion No. 528's

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[446] While the Proxy Group Policy Statement rejected Dr. Vilbert's Benchmark Model, the Commission recognizes that the D.C. Circuit has held that a policy statement is not precedent and is not finally determinative of the issues to which it is addressed. *Pacific Gas & Electric Co. v. FPC*, 506 F.2d 33, 38 (D.C. Cir. 1974). For that reason, we have considered El Paso's proposal to use the Benchmark Model in this proceeding on a *de novo* basis, without regard to the findings of the Policy Statement.

[447] In contrast to the Policy Statement, Opinion No. 486-B was a decision in an individually litigated adjudication. As such, Opinion No. 486-B constitutes precedent which the Commission may, under appropriate circumstances, apply in a stare decisis manner in subsequent cases. *Williston v. FERC*, 165 F.3d 54, 61.

[448] El Paso asserts that the long-term growth projection for an MLP should never be any less than the projected inflation rate included in the GDP growth projection. El Paso asserts that, in this case, the inflation rate is 1.92 percent. The long-term growth projection we adopt here does exceed 1.92 percent, since 50 percent of GDP is 2.27 percent. That results in an annual long-term growth projection that is approximately 15 percent higher than the rate of inflation.

holding that the zone of reasonableness for determining El Paso's ROE in this case is 10.39 percent to 11.08 percent, with a median of 10.55 percent.

3. <u>Placement of El Paso's ROE within the Proxy Group</u>

285. We now turn to the issue of where in the zone of reasonableness to set El Paso's ROE. In Opinion No. 528 the Commission reversed the Presiding Judge's finding in the Initial Decision that El Paso's relative risk justifies allowing it an ROE "well above" the median ROE of the proxy group companies. Finding that the Presiding Judge's risk analysis with respect to El Paso was flawed, the Commission determined that El Paso's allowed ROE should be set at the median of the range of the proxy group companies, or 10.55 percent.[449] El Paso seeks rehearing of that decision. As discussed more fully below, the Commission finds that the record does not support El Paso's claims that it faces anomalous business and financial risks that would warrant placing El Paso above the median of the range of the proxy group companies, and thus we deny El Paso's request for rehearing on this issue.

<u>Opinion No. 528</u>

286. As noted, in Opinion No. 528 the Commission reversed the Presiding Judge's decision to place El Paso above the median of the range of reasonable returns. In making that finding the Commission found the Presiding Judge's support for his findings with regard to El Paso's financial risk was lacking. Specifically, the Commission found that the Presiding Judge's reliance on a one notch difference on Standard & Poor's (S&P) financial risk scale between average financial risk and El Paso's financial risk was insufficient to constitute highly unusual circumstances necessary to justify a deviation from the median ROE. The Commission further noted that the "aggressive" rating purportedly assigned to El Paso was actually for its parent El Paso Corporation, and that the record showed El Paso's stand-alone financial ratios to be stronger than that of its parent.[450]

287. The Commission also found fault with the Presiding Judge's failure to compare El Paso's debt ratio to that of the proxy group companies, his failure to address record evidence indicating that El Paso's debt ratio was only slightly higher than that of the debt ratios of the proxy group companies,[451] and his failure to address record evidence

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[449] Opinion No. 528, 145 FERC ¶ 61,040 at P 686.

[450] *Id.* PP 687-688.

[451] *Id.* P 689.

regarding El Paso's credit rating and instead relying solely on S&P's financial risk scale.[452] The Commission concluded that El Paso's credit rating was at or close to investment grade, and close to the range of credit ratings for the proxy group companies that had credit ratings. Based on that finding, and the finding that El Paso's debt ratio reflected a level of financial risk close to the average of the proxy group companies, the Commission concluded that El Paso's financial risk was not anomalously high so as to warrant an ROE above the median.[453]

288. The Commission also found several deficiencies with regard to the analysis of El Paso's business risk. The Commission explained that the sole relevant risk perception for ROE purposes are those of investors in the capital markets, and that the best way to evaluate investor perceived risk is through published investor services, like S&P, who are likely relied on by investors when establishing their risk perceptions.[454] The Commission found that the relative risk analysis conducted in the Initial Decision was not shown to reflect investors' risk perceptions, and in the absence of such evidence the findings of relative business risk in the Initial Decision are speculative.[455] The Commission also found that the Presiding Judge had failed to address relevant evidence that weighed in favor of reducing El Paso's business risk.

289. The Commission found, for instance, that the Presiding Judge did not weigh the fact that El Paso operates under a straight fixed-variable rate design and thus recovers approximately 95 percent of its costs without actually shipping any natural gas. The Commission also found that the Presiding Judge's holdings that El Paso should be fully insulated from the risk of its unsubscribed capacity and discounted contracts, and allowing El Paso to design its rates in a manner that essentially avoids these risks, minimizes El Paso's business risk.[456]

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[452] *Id.* P 690.

[453] *Id.* P 691.

[454] *Id.* P 693.

[455] *Id.* P 694.

[456] *Id.* P 697 & n.1026. The Commission noted that this fact distinguished El Paso's circumstances from those of the Commission's recent finding in Opinion No. 524, relating to Portland Natural Gas Transmission Company, where the Commission found justification for granting Portland an ROE at the top of the range of reasonable returns. The Commission noted placing Portland at risk for its unsubscribed capacity weighed in favor of placing Portland at the top of the range, while in the El Paso

(continued...)

290. Finally, the Commission noted that the crux of analysis proposing to demonstrate deviation from the median ROE is a comparison of the risk level of the subject company to the risk levels of each of the proxy group companies. The Commission found that the absence of a satisfactory analysis to this effect was sufficient by itself to reverse the Presiding Judge's finding that El Paso's business risk warranted an ROE above the median.[457]

Request for Rehearing

291. El Paso requests rehearing of the Commission's decision to reverse the Presiding Judge and to instead assign El Paso an ROE at the median of the proxy group returns. Generally El Paso states that the Commission ignored the Presiding Judge's thorough evaluation of El Paso's risk profile that led to the finding that El Paso has anomalously high business and financial risk and should be placed well above the median ROE of the proxy group. El Paso states that the Commission ignored the Presiding Judge's evaluation because it found it was "not based on investors' risk perceptions."[458] El Paso claims that instead the Commission placed undue reliance on one S&P report that listed El Paso's risk as excellent, even though the report is flawed and inconsistent with the record evidence. El Paso states that the record overwhelmingly supports the Presiding Judge's findings and the Commission's reversal of his conclusions is contrary to the evidence.

292. With regard to business risk, El Paso asserts that the Commission essentially ignored the Presiding Judge's analysis and findings based on record evidence that demonstrated El Paso's anomalously high business risk. El Paso argues that it faces substantial competitive and regulatory risks in the areas it serves, which are exacerbated by the relatively short remaining life on its existing long-term contracts. According to El Paso, those risks coupled with declining throughput, shipper defections, the high percentage of sculpted contracts that El Paso has, and the economic downturn in areas served by El Paso, make it anomalously risky as compared to the other proxy group members, and thus the Commission was wrong to overturn the Presiding Judge's

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proceeding the Presiding Judge's ruling that El Paso is entitled a full discount adjustment and should not be required to absorb the risk for a portion of the cost of those discounts insulated El Paso from such risk. *Portland Natural Gas Transmission System*, Opinion No. 524, 142 FERC ¶ 61,197, at PP 382, 395 (2015).

[457] Opinion No. 528, 145 FERC ¶ 61,040 at P 698.

[458] El Paso Rehearing at 75.

determination that El Paso has sufficiently high risk to warrant an ROE above the median of the range of reasonable returns.[459]

293. El Paso asserts that the Presiding Judge found that El Paso faces anomalously high business risks relative to the companies in the proxy group for several reasons: (1) El Paso faces substantial competitive risks in the areas it serves; (2) El Paso faces heightened regulatory risks in the areas it serves; (3) El Paso's contract demand and throughput has been declining due to competitive pressures and shipper defections; (4) the competitive and regulatory risks El Paso faces are heightened by the short remaining term in El Paso's long term contracts; (5) El Paso has a high number of sculpted contracts that are unique; and (6) El Paso is subject to the unique impact of the economic downturn in the areas served by El Paso.

294. El Paso states that the Presiding Judge found that El Paso is at a competitive disadvantage in its major markets primarily because the pipelines against which El Paso competes can offer lower-priced Rocky Mountain natural gas or lower fuel costs, while El Paso's cheapest source of accessible supply is the San Juan Basin, which is inherently more expensive.[460]

295. El Paso also claims that the record supports the Presiding Judge's finding that El Paso faces heightened regulatory risks in the areas it serves.[461] El Paso states that the record indicates that the Arizona Corporation Commission (ACC) has encouraged shippers to participate in new competitive pipeline projects with significantly higher costs and recourse rates than El Paso offers, and that El Paso's business environment has been altered by the CPUC's promotion of supply diversity via new competing pipelines, resulting in policies that increase El Paso's regulatory risk.

296. El Paso also claims that the Presiding Judge found that El Paso faces high business risk due to declining throughput which has resulted from competitive pressures and shippers leaving its system.[462] El Paso states that the Presiding Judge relied on record evidence showing a 28 percent decrease in delivery volumes between January 2009 and the first quarter of 2011 on El Paso's system, evidence that El Paso was forced to sell capacity on a short-term basis, which further eroded its long-term contract and

[459] *Id.* at 76-80.

[460] *Id.* 76-77.

[461] *Id.* at 77.

[462] *Id.* at 78.

discounting position when 24 percent of El Paso's contract demand came up for renewal in 2011.

297. El Paso claims further that its competitive and regulatory risks are exacerbated by the short time remaining on its customers' long-term contracts.[463] El Paso states that the Presiding Judge found that its long-term contract portfolio has a weighted average remaining life of only 2.7 years, as compared to the weighted average remaining contract life of 5-6 years for the proxy companies he recommended, and is shorter than 22 of the 27 other FERC-regulated pipelines included in the proxy group companies proposed by any witness in the case. El Paso states that as its contracts come up for renewal in a relatively short period of time, it faces the prospect of reduced demand and throughput, shorter terms, increased discounting and shipper defections and an increase in the risk of it not recovering the costs its rates are designed to collect. El Paso states that the Presiding Judge also found that El Paso has a high percentage of sculpted contracts, which allow shippers to have different maximum quantities on a monthly basis. El Paso claims its high percentage of these type of contracts is unique to its system, and increases its business risk.

298. El Paso's final business risk argument is that the purportedly unique economic downturn in the areas it serves increased its business risk. El Paso argues that as reported for June 2010, unemployment rates in California, Nevada and Arizona were among the highest in the country and that the depressed conditions in these states weakened the demand for service from El Paso to a greater extent than other pipelines, including those in the proxy group.

299. With respect to financial risk, El Paso claims that the Commission erred by relying on a purportedly hearsay S&P report to the exclusion of the substantial evidence in the record. El Paso states that the placement of El Paso's ROE within the range of proxy group returns based solely on published investor services, or in this case one analyst's report, to the exclusion of a qualitative analysis performed by an administrative law judge based on record evidence, is arbitrary and capricious and has never been the Commission's policy or practice. El Paso states that relying on one such single report would abdicate the Commission's decision-making function to investment analysts, or in this case one such analyst.

300. El Paso argues that the Commission's assumption that "investors" rely on such analyst reports has not been proven. El Paso states that the S&P report in question is hearsay and not subject to discovery or cross examination , while the Presiding Judge's findings are based on a thorough vetting of the substantial evidence in the record,

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[463] *Id.*

including expert testimony subject to discovery and cross examination. El Paso reiterates that the Presiding Judge found that the conclusion in the S&P report that El Paso has an "excellent" business profile is "overwhelmingly undermined by the record" in the proceeding. El Paso further claims that the Trial Staff Witness that suggested use of the S&P report was appropriate agreed that most of the factors that the analyst relied on to conclude that El Paso had an excellent business profile actually demonstrated the exact opposite. According to El Paso, the discussion of the following elements in the report are those indicating a high risk company: (1) declining throughput; (2) weak demand in El Paso's service territories; (3) non-renewal of expiring contracts due to lower basis differentials; (4) the fact that reservation charges account for 89 percent of El Paso's capacity, which is collected independent of throughput levels; (5) an average contract life of about three years as compared to five to six years on most other pipelines; and (6) the fact that El Paso extends 10,200 miles from three supply basins to its service territories. El Paso states that the Trial Staff witness agreed that topics 1, 2, 3, and 5 listed above suggested that El Paso faced high business risks, and incorrectly assumed that the 4th and 6th topic counterbalanced the other risks listed in the report. El Paso states that the notion that the Commission's decision on business risk should be based on one hearsay analyst report regardless of its accuracy because investors presumably rely on it would turn an evidentiary hearing into a battle of written reports by authors who cannot be questioned as to the basis for their conclusions or their qualifications to provide such opinions.

301. El Paso states that in *Kern River*[464] the Commission performed an analysis of Kern River's actual business risks based on the competition it faces and did not rely solely on investment analysts' conclusions. El Paso argues that in the past the Commission has stated that it does not place great significance on such analyst assessments.[465]

Commission Determination

302. The Commission's traditional assumption with regard to relative risk is that natural gas pipelines "generally fall into a broad range of average risk absent highly unusual circumstances that indicate an anomalously high or low risk as compared to other pipelines."[466] As the Commission has explained,

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[464] *Kern River Gas Transmission Co.,* Opinion No. 486-E. 136 FERC ¶ 61,045 at PP 200-206 (2011) (order on initial decision on post-contract step-down rates).

[465] El Paso Rehearing at 84 (citing *Transcontinental Gas Pipe Line Corp*., Opinion No. 414, 80 FERC ¶ 61,157, at 61,675 (1997)).

[466] *Transcontinental Gas Pipeline Corp.*, 90 FERC ¶ 61,279, at 61,936 (2000) (*Transco*).

> While the Commission stated in Opinion No. 414-A that parties may present evidence to support any return on equity that is within the zone of reasonableness, the tools available to the Commission for determining return on equity are blunt. Therefore the Commission is skeptical of its ability to make carefully calibrated adjustments within the zone of reasonableness to reflect the generally subtle differences in risk among pipelines. Unless a party makes a very persuasive case in support of the need for an adjustment and the level of the adjustment proposed, the Commission will set the pipeline's return at the median of the range of reasonable returns.[467]

As discussed below, we affirm the finding in Opinion No. 528 that El Paso has failed to overcome the presumption of average risk, and thus that its ROE should be set at the median of the zone of reasonable returns.

a. <u>Financial Risk</u>

303. As we stated in Opinion No. 528, the Presiding Judge's finding that El Paso exhibits higher than average financial risk as compared to the proxy group is flawed and does not support a finding of anomalously high risk. As we found there, El Paso's credit ratings by S&P, Moody's, and Fitch are at or close to investment grade and near the average credit ratings of the proxy group companies with such ratings. Further, the Presiding Judge's near exclusive reliance on the one-notch differential on the S&P financial risk scale to determine that El Paso has anomalously high financial risk does not justify a deviation from the median ROE, particularly given that difference reflects the financial risks of El Paso's parent corporation, which include high risk exploration and production operations. Additionally, El Paso's debt ratio reflects a level of financial risk commensurate with that of the proxy group companies. Accordingly, we affirm the finding that the record fails to support a deviation from the median ROE based on anonymously high financial risk.

304. As noted in Opinion No. 528, the Presiding Judge based his financial risk analysis primarily on two reports issued by S&P on April 21, 2011[468] and June 20, 2011,[469] each

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[467] *Id. See also* Opinion No. 524, 142 FERC ¶ 61,197 at P 382 & n.479; Proxy Group Policy Statement, 123 FERC ¶ 61,048 at P 7.

[468] Ex. S-12 at 91-109.

[469] Ex. S-28.

entitled "U.S. Midstream Energy Companies, Strongest to Weakest." In those reports, S&P not only set forth each listed company's Issuer Credit Rating, but also graded each company's "financial risk profile" and its "business risk profile." In finding that El Paso's financial risk was somewhat higher than the financial risk of the proxy group, the Presiding Judge relied primarily on S&P's financial risk profiles of El Paso and the proxy group firms, which characterized El Paso Corporation's financial risk profile as "aggressive" and thus slightly more risky than the proxy group average financial risk profile of "significant" on the same scale.[470]

305. However, the Presiding Judge failed to recognize that El Paso's "aggressive" financial risk rating was based on the consolidated risk of El Paso's parent corporation, El Paso Corporation, and thus reflected the higher risks associated with the parent's exploration and production operations. In a separate report S&P issued on April 29, 2011 concerning El Paso itself (referred to as EPNG in the report), S&P explained that it based its BB credit rating for "[El Paso Corporation] and its subsidiaries, including [El Paso], on our consolidated credit methodology, resulting in the same corporate credit rating for the holding company and each of its subsidiaries. The ratings on [El Paso Corporation] reflect . . . an aggressive financial profile, which incorporates the stability of the company's interstate natural gas pipeline systems (about two-thirds of projected 2010 cash flow), partly offset by the risks associated with its exploration and production (E&P) segment."[471] The April 29, 2011 S&P report then stated that "[El Paso's] stand-alone financial ratios are stronger than [El Paso Corporation's] consolidated ratios. We view [El Paso Corporation's] *consolidated* financial risk profile as aggressive, mainly because of its high debt balance and weak credit metrics."[472] That report also stated, "We view [El Paso Corporation's] E&P segment as carrying more operating and financial risk than the pipeline segment, largely due to the potential for significant cash flow volatility resulting from commodity price changes."[473] It is thus clear that the "aggressive" financial risk profile S&P assigned to El Paso arose from S&P's use of a "consolidated credit methodology" and the "aggressive" rating was, as the April 29, 2011 S&P report clearly stated, a "consolidated financial risk profile" in which El Paso's stable pipeline

[470] Opinion No. 528, 145 FERC ¶ 61,040 at P 687. In grading each company's financial risk profile, S&P uses a six-step scale, ranging from "minimal" to "highly leveraged." "Aggressive" is one step below "highly leveraged", and "significant" is one step below "aggressive." Ex. S-10 at 35.

[471] Ex. S-12 at 160.

[472] *Id*. (emphasis supplied).

[473] *Id*. at 161.

business and stronger financial ratios were offset by the financial risks of El Paso Corporation's E&P business. Taking these facts into consideration, S&P's assignment to El Paso of a financial risk profile one step above the average "significant" financial risk profile of the proxy group does not support a finding that El Paso has higher than average financial risk.

306. Moreover, the Presiding Judge's analysis relied solely on the S&P financial risk scale and failed to address the record evidence of El Paso's credit ratings by other investor services.[474] Moody's Investor Service (Moody's), unlike S&P, issues separate credit ratings for El Paso and its parent, El Paso Corporation. A February 2010 Moody's credit report gave El Paso an investment grade credit rating of Baa3, in contrast to the below investment grade Ba3 credit rating it gave El Paso Corporation.[475] The same report gave Boardwalk a rating of Baa2, one notch above El Paso, and Williams Partners a credit rating of Ba2, two notches below El Paso. Moreover, on June 2, 2011, Moody's issued a report confirming El Paso's Baa3 credit rating and changed its rating outlook from stable to positive, because of El Paso Corporation's announcement of plans to spin off its E&P business.[476] The same report stated that El Paso Corporation's Ba3 credit rating "has been a limiting factor in the ratings for . . . El Paso's pipeline companies."[477] Thus, these two Moody's reports support findings that El Paso's financial risk is average as compared to the proxy group. While its credit rating is below that of one member of the proxy group, it is above that of another member of the proxy group. Moreover, if El Paso were rated on a pure stand-alone basis, its Moody's credit rating would likely be higher, placing it on a par with Boardwalk.

307. Similarly, Fitch issues separate credit ratings for El Paso and El Paso Corporation. On May 24, 2011, Fitch issued a report confirming its BBB- investment grade rating of El Paso and BB+ non-investment grade rating of El Paso Corporation. Fitch, like Moody's, revised its rating outlook for both companies from stable to positive, because of the announced spin-off of the E&P business.[478] The same report stated that "Fitch has historically linked the ratings of [El Paso Corporation's] pipelines to that of their parent companies given the significant operating and financial affiliations the subsidiaries have

[474] Initial Decision, 139 FERC ¶ 63,020 at P 48.

[475] Ex. S-12 at 180.

[476] *Id*. at 76.

[477] *Id*. at 77

[478] *Id*. at 70.

with El Paso Corporation. Given this linkage, Fitch has rated the pipelines one notch higher than [El Paso Corporation], lower than their standalone credit metrics and business profiles may indicate."[479] While the record does not contain Fitch credit ratings for members of the proxy group,[480] Fitch's BBB- credit rating for El Paso is comparable to Moody's Baa3 credit rating, and Fitch, like Moody's, indicates that if it rated El Paso on a pure stand-alone basis, it would likely give El Paso a higher credit rating. Thus, the credit ratings data in the record does not support the conclusion that El Paso has satisfied its burden of proving that it has above average financial risk as compared to the proxy group members.[481]

308. The Presiding Judge also failed to analyze and compare El Paso's debt ratio to the debt ratios of the proxy group members. As we noted in Opinion No. 528, the most fundamental aspect of a company's financial risk is the amount of debt it has. The record evidence on debt ratios shows that El Paso's financial risk is at most "slightly higher" than the proxy group, and that El Paso's own witness concludes based on debt ratio data that El Paso is "of average risk" when compared to the other proxy group members.[482] The record demonstrates that El Paso's long term debt ratio of approximately 53.5 percent,[483] is lower than the debt ratio of two of the proxy group members, Spectra Corporation (56.56 percent) and Williams Partners (55.63 percent),

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[479] *Id.* The record does not contain any evidence as to Fitch's credit ratings for the proxy group members.

[480] While El Paso's rehearing request and Witness Vilbert's testimony reference an investment rating for El Paso by Fitch (Rehearing at 85; Ex. 179 at 49), a review of the record indicates that there is no such report in the record, and other than in his passing reference, Dr. Vilbert does not point to where in the record that report is purportedly located.

[481] As El Paso points out in its rehearing request, a staff witness testified that El Paso's financial risk was "slightly higher" than that of the proxy group. Ex. S-10 at 38. Even accepting this testimony, such slightly higher financial risk would not support a finding of highly unusual circumstances indicating anomalously high risk. In any event, we find that the staff witness's testimony did not adequately take into account the Moody's and Fitch credit reports, discussed above.

[482] Ex. EPG-179 at 50.

[483] Ex. S-11, Schedule 1. This figure takes into account our adoption of staff's proposal to exclude El Paso's loan to its parent and undistributed subsidiary earnings from the equity component of its capital structure.

only slightly above that of Boardwalk (50.09 percent), and thus greater than only the remaining two proxy group members, Spectra Partners (30.50 percent) and TC Pipelines (21.29 percent).[484] This data, which the Presiding Judge did not consider, supports the position that El Paso's risk is not highly unusual.

309. Accordingly, as in Opinion No. 528, we find that El Paso has not shown its financial risk to be such that it constitutes highly unusual circumstances that would warrant placement above the median of reasonable results. As shown, El Paso has investment grade credit ratings from Moody's and Fitch that are close to the credit ratings of the members of the proxy group for this proceeding. Further, reliance on the S&P's finding that El Paso had "aggressive" financial risk is misplaced as that determination related to El Paso's parent corporation, which included exploration and production operations. Moreover, the debt ratio data indicates that El Paso's risk is average when compared to the other proxy group companies. As compared with this evidence, the one step difference in a six-step financial risk scale assigned to El Paso's parent by S&P does not justify a finding that El Paso has unusually high financial risk.

b. <u>Business Risk</u>

310. The Presiding Judge found that El Paso exhibited higher than average business risk based on several factors, including (1) El Paso exhibits enhanced competitive and business risks in its primary markets, California and Arizona;[485] (2) El Paso's competitive risk is exacerbated by its regulatory risk;[486] (3) there is a relatively short remaining life of its firm transportation contracts as compared to the average contract life on most other pipelines, including those owned by the proxy members;[487] (4) El Paso is experiencing declining throughput;[488] and (5) El Paso is unique with regard to its high percentage of "sculpted" contracts.[489] According to the Presiding Judge, each of these factors taken separately is at least uncommon but taken in the aggregate they satisfy the "highly unusual circumstances" requirement. As discussed below, we find the record does not

[484] Ex. S-11, Schedule 15.

[485] Initial Decision, 139 FERC ¶ 63,020 at P 56.

[486] *Id.* P 53.

[487] *Id.* P 50.

[488] *Id.* P 51.

[489] *Id.* P 57.

support reliance on these items as an indicator of El Paso's purportedly highly unusual business risk.

311. First, aside from the contract life factor, the Presiding Judge's analysis fails to compare the above purported risk factors with those of the proxy group members. Rather, his analysis focuses on El Paso's business risks as compared to other pipelines serving California and Arizona, only one of which (North Baja) appears to be owned by a member of the proxy group. As we stated in Opinion No. 528, however, "a comparison between the risk level of the subject company and the risk level of the proxy group companies" is the very crux of an analysis attempting to demonstrate high risk that warrants a deviation from the median ROE.[490] As discussed below, while the record may show that El Paso may face some business risks due to the factors cited by El Paso, it does not show that El Paso has such anomalously high risk as compared to the other proxy group members to justify a holding that investors would view El Paso as falling outside the "broad range of average risk"[491] faced by pipelines.

312. As El Paso states in its rehearing request,[492] the Commission considers credit ratings in determining a pipeline's relative business risk as compared to the members of the proxy group. The Commission explained in Opinion No. 524-A, "Major investment advisory services such as S&P have many subscribers, and thus their opinions are highly relevant to a determination of how investors evaluate the risk of any particular investment."[493] The record in the present case contains credit reports by both S&P and Moody's analyzing El Paso's business risk as compared to numerous other firms in the natural gas pipeline business, including several firms in the proxy group. As discussed below, contrary to El Paso's assertions, those reports support a finding that investors do not view El Paso as having significantly more business risk than the proxy firms.

313. El Paso contends that Opinion No. 528 relied solely on the April 29, 2011 S&P report concerning El Paso to the exclusion of S&P's April 21 and June 20, 2011 reports

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[490] Opinion No. 528, 145 FERC ¶ 61,040 at P 698.

[491] *Transco*, 90 FERC ¶ 61,279 at 61,936.

[492] El Paso Rehearing at 85 (citing Opinion No. 486-B, 126 FERC ¶ 61,034 at P 137).

[493] *Portland Natural Gas Transmission System*, 150 FERC ¶ 61,107, at P 215 (2015). *See also Transco*, 90 FERC ¶ 61,279 at 61,937; Opinion No. 414-A, 84 FERC ¶ 61,084, at 61,427 (1998).

ranking U.S. Midstream Energy Companies from strongest to weakest.[494] El Paso points out that the April 21, 2011 report ranks El Paso 57th out of 82 companies and the June 20, 2011 report ranks El Paso 60th. El Paso also points out that S&P's BB issuer credit rating for El Paso is lower than that for every company in the proxy group. However, as described above, S&P assigns each company a "business risk profile" from "weak" to "excellent," in addition to a credit rating. It is S&P's business risk profile rating that is most relevant for purposes of assessing El Paso's business risk as compared to the proxy group. S&P's April 21 and June 20, 2011 reports both give El Paso a business risk profile rating of "excellent." That is higher than the business profile rating of all the other proxy group members in the two reports.[495] Both reports assign business risk profiles to Boardwalk and Spectra Corporation of "strong," one step below El Paso's business risk profile. Both reports assign Williams a business risk profile of "satisfactory," two steps below El Paso's business risk profile.

314. El Paso emphasizes that S&P's issuer credit rating for El Paso is BB, which is lower than the S&P credit ratings of BBB+ for Boardwalk, BBB for Spectra Corp., and BBB- for Williams.[496] However, as discussed above, S&P based its BB credit rating for El Paso on its "consolidated credit methodology," requiring that it give the same corporate credit rating to El Paso as it gives to its parent, El Paso Corporation.[497] By contrast, S&P assigns separate "business risk profiles" to El Paso and El Paso Corporation. While S&P assigned El Paso an "excellent business risk profile," it assigned El Paso Corporation only a "satisfactory" business risk profile, two steps below that of El Paso. This is a strong indication that S&P's BB credit rating for El Paso was based on the greater business risks for El Paso Corporation's non-pipeline E&P business, rather than any business risk S&P might see in El Paso's pipeline operations.

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[494] El Paso Rehearing at 85-87.

[495] Ex. S-12 at 92-93. *See also* S&P's June 21, 2011 report, finding the same (Ex. S-28 at 3-4).

[496] Ex. S-12 at 93.

[497] *Id.* at 160. In its Rehearing, El Paso asserts that S&P's BB credit rating was for El Paso and not for the consolidated companies of its parent El Paso Corporation (at page 86). However, this assertion is clearly contrary to S&P's explanation in its April 29, 2011 report concerning El Paso that it based the BB credit rating for "[El Paso Corporation] and its subsidiaries, including [El Paso], on our consolidated credit methodology, resulting in the same corporate credit rating for the holding company and each of its subsidiaries."

315. Moreover, the commentary in the April 29, 2011 S&P report on El Paso indicates that S&P does not view El Paso's pipeline operations as having unusually high business risk and confirms that S&P considers El Paso Corporation's business risks as arising from its E&P business. That report recognized that El Paso's throughput declined about 15 percent in 2010, "primarily due to weak demand for natural gas in its service territories and the nonrenewal of expiring contracts due to lower basis differentials."[498] The report also recognized that the approximately three-year average life of El Paso's contracts with its shippers is lower than the five to six year average life on most other pipelines. "Nevertheless," S&P stated, "reservation charges account for 89 percent of capacity, which provides some visibility around future cash flows because this capacity is independent of throughput levels."[499] The report also stated that the pipeline "extends 10,200 miles from the San Juan, Permian, and Anadarko basins in northern New Mexico and southern Colorado through the southwestern U.S. and into California and portions of Mexico." The S&P report concluded that the "pipeline segment has an excellent business profile because this segment produces stable cash flows, has access to diverse sources of natural gas supplies, competitive rates and increasing demand in expanding markets."[500]

316. In contrast, the S&P report stated, "We view El Paso [Corporation's] E&P segment as carrying more operating and financial risk than the pipeline segment, largely due to the potential for significant cash flow volatility resulting from commodity price changes. In addition, the capital-intensive E&P business compels continued reinvestment to replace production." The report notes that the relative "stability of the [parent] company's interstate natural gas pipeline systems" is "offset by the risks associated with its exploration and production segment."[501] Accordingly, it is reasonable to find that the factors that led to S&P's BB credit rating of El Paso Corporation and its subsidiaries were more likely attributable to the parent's riskier exploration and production operations, than its less risky interstate pipeline operations.

317. As noted above, in addition to the three S&P reports discussed above, the record also contains credit ratings by Moody's for El Paso and two of the firms in the proxy group. As El Paso notes, Moody's gives El Paso a credit rating of Baa3 with a Stable outlook.[502] El Paso implies that Moody's assignment to El Paso of its lowest investment

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[498] Ex. S-12 at 160.

[499] *Id.*

[500] *Id.*

[501] *Id.*

[502] *Id.* at 179.

grade credit rating demonstrated El Paso was at greater business risk than the other proxy group members. A close review of the Moody's report, however, shows that the Baa3 credit rating it gave El Paso was only one notch below Moody's Baa2 rating for Boardwalk and was two notches above the non-investment grade Ba2 rating it gave Williams.[503] Thus, the Moody's credit ratings place El Paso squarely in the middle of the proxy group and also support a finding that El Paso has average business risk as compared to the proxy group.

318. The Commission concludes that the evidence in the record concerning credit ratings issued by investment services supports a finding that El Paso has both average financial risk and average business risk. El Paso, however, contends on rehearing that the Commission cannot rely solely on the reports of investment analysts in determining whether a pipeline has average business risk, and that the Commission has previously conducted its own analysis of how investors would view a pipeline's business risk as compared to the proxy group.[504] El Paso asserts a finding that it has higher than average business risk is justified by the Presiding Judge's findings that (1) El Paso exhibits enhanced competitive and business risks in its primary markets; (2) El Paso's competitive risk is exacerbated by its regulatory risk; (3) there is a relatively short remaining life of El Paso's firm transportation contracts; (4) El Paso is experiencing declining throughput; and (5) El Paso has a high percentage of "sculpted" contracts. El Paso also contends that Opinion No. 528 failed to adequately distinguish its holding in this case that El Paso has average business risk from the Commission's holding in Opinion No. 524 that Portland has unusually high risk justifying placing Portland's ROE at the top of the range of reasonableness, despite the fact Portland has a higher S&P credit rating than El Paso.

319. The Commission does not disagree that an analysis of the relative risk of a pipeline as compared to the proxy group may look beyond the reports of investment advisory services. However, as discussed below, the record in this proceeding does not warrant finding that El Paso faces "highly unusual circumstances that indicate an anomalously high risk," of the type Opinion Nos. 524 and 524-A found with respect to Portland.

i. Competitive Risk in Primary Markets

320. El Paso points out that the Presiding Judge in the Initial Decision found that El Paso faces enhanced competition and thus increased business risks in its two major

[503] *Id.* at 180.

[504] El Paso Rehearing at 83-84.

markets, Arizona and California.[505] The Presiding Judge based those findings on the fact that two of the four major pipelines competing with El Paso to serve California demand historically have had lower natural gas commodity prices than San Juan Basin,[506] and that Kern River had recently increased its pipeline capacity to California, which purportedly displaced some El Paso and some Transwestern San Juan Basin-sourced natural gas with cheaper Rocky Mountain-sourced natural gas.[507] According to the Presiding Judge, although both El Paso and Transwestern are primarily sourced from San Juan Basin, Transwestern has lower fuel costs and frequently dispatches first.[508] Based on those facts, the Presiding Judge concludes that "GTN, Kern River and Transwestern all have at least some competitive advantage over [El Paso] in serving the California market."[509] The Presiding Judge also found that Transwestern had "at least some competitive advantage over [El Paso] in the Arizona market" based on Transwestern's construction of a 500,000 Dth/day lateral from its mainline to Phoenix, Arizona.[510] According to the Presiding Judge, the record indicates that the ACC policy encouraging new competitive pipeline projects facilitated Transwestern's construction of this new lateral, and that five El Paso shippers subsequently contracted for approximately 370,000 Dth/day of that capacity, and two of those shippers turned back or converted approximately 200,000 Dth/day of their previously held El Paso capacity. Based on these findings, the Initial Decision concludes that these circumstances indicate El Paso exhibits enhanced competitive/business risks in the California and Arizona markets.

321. As we did in Opinion No. 528, the Commission rejects El Paso's arguments that investors would view it as facing highly unusual business risk because of the competition it faces in the Arizona and California markets so as to warrant an above average ROE. First, with respect to Arizona, even if one competing pipeline has "at least some competitive advantage" over El Paso, that does not rise to the level of "enhanced business risk" or demonstrate highly unusual circumstances, and thus does not support awarding an ROE above the median. Further, the record indicates that the referenced Transwestern lateral was nearly 75 percent subscribed, and thus the opportunity for El Paso customers

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[505] Initial Decision, 139 FERC ¶ 63,020 at P 56.

[506] *Id.* (citing Ex. EPG-183 at 13; Ex. EPG-177 at 23-24; Ex. EPG-192 (a) & (b)).

[507] *Id.* (citing Ex. EPG-183 at 14).

[508] *Id.* (citing Ex. EPG-183 at13; Ex. EPG-177 at 24).

[509] *Id.*

[510] *Id.*

to further contract with Transwestern on that pipeline was limited.[511] In addition, an El Paso witness testified that use of natural gas for electric generation is increasing in Arizona, because of coal plant conversions and future decommissioning.[512] Similarly, evidence related to El Paso's purported unusually high competitive risks in California does not demonstrate that El Paso requires an above average ROE. Vague references to historically lower natural gas prices for two of four pipelines with which El Paso competes and increased capacity built into California by one of those pipelines, for which the Presiding Judge concludes only that the competing pipelines have "at least some competitive advantage over [El Paso] in serving the California market," do not reasonably translate to a finding that El Paso has enhanced competition in those markets so as to render its circumstances competitively anomalous. The record indicates that El Paso's market share of contracted pipeline capacity to California has decreased only slightly from 30 percent in 2004 to approximately 27 percent in 2010, despite the increased capacity serving California.[513] Capacity turnback and competition based on expansion of facilities into El Paso's traditional markets are business risks faced by nearly all interstate pipelines subject to our jurisdiction and do not render El Paso unusually or highly risky when compared to the other pipelines in the proxy group.

322. El Paso also has projected growth in demand for natural gas in Mexico of two Bcf over the next ten years,[514] and it has already executed contracts with two shippers located in Mexico for service of 185,000 Dth per day on an expansion of El Paso's Willcox Lateral to the U.S.-Mexican border.[515]

323. While we recognize that El Paso is currently experiencing competitive pressures in serving its California market,[516] we find that other considerations would likely lead investors to nevertheless consider El Paso to fall within the broad range of average business risk as compared to the proxy group. Investors would recognize that El Paso is

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[511] *See, e.g.*, Ex. EPG-177 at 25-26.

[512] Tr. 621 (testimony of Mr. Wayne).

[513] Ex. EPG-194.

[514] Ex. IS-14 at 40.

[515] Ex. IS-17 at 2.

[516] The Presiding Judge found that approximately one third of El Paso's total long term transportation capacity to California is either unsubscribed or deeply discounted. Initial Decision, 139 FERC ¶ 61,020 at P 53 n.48.

one of the largest interstate pipelines in the United States, extending from the Permian, Anadarko, and San Juan supply basins in Texas, New Mexico, and southern Colorado across the southwestern U.S. to California, and with a service area stretching across six states and into Mexico.[517] A pipeline's access to diverse supply basins with substantial proven reserves is generally considered to reduce its business risk.[518] Moreover, the Presiding Judge found that El Paso successfully competes for the San Juan-sourced natural gas supplies, which El Paso described as being lower-cost than natural gas sourced from the Permian Basin (where El Paso claims it has competitive advantages).[519] Similarly, a pipeline's ability to deliver natural gas into geographically diverse markets is also considered to reduce a pipeline's business risk.[520] S&P's April 29, 2011 report on El Paso pointed to both El Paso's access to diverse supply basins and the fact it serves geographically diverse markets as factors underlying its excellent business risk profile.[521]

324. An even more important factor reducing El Paso's business risk is its straight fixed variable (SFV) rate design, together with Opinion No. 528's affirmance of the Presiding Judge's finding that El Paso should not be required to absorb a share of the costs of its discounting.[522] El Paso's SFV rate design allows it to recover its fixed costs through reservation charges paid by firm shippers based on their contract demand rather than throughput. This helps insulate El Paso from the risk of reduced throughput. In fact, the April 29, 2011 S&P report on El Paso specifically recognizes that the risk of El Paso's declining throughput is mitigated by the fact that El Paso recovers 89 percent of the value

[517] Ex. EPG-323 at 84.

[518] *See* S&P's April 21, 2011 report, discussing factors it considers in evaluating a pipeline's business risk. Ex. S-12 at 3-4.

[519] Initial Decision, 139 FERC ¶ 63,020 at P 52. *See also* Ex. EPG-177 at 24. The Presiding Judge rejected El Paso's contention that its supply risk was higher than average, finding that El Paso had not explained how or why the circumstances as described elevate El Paso's supply/production risk vis-à-vis other pipelines.

[520] *See* S&P's April 21, 2011 report, Ex. S-12 at 3-4.

[521] Ex. S-12 at 160.

[522] Opinion No. 528, 145 FERC ¶ 61,040 at PP 389-396.

of that capacity through reservation charges that it collects whether or not it actually ships any natural gas.[523]

325. Moreover, as we noted in Opinion No. 528, El Paso's business risk is further reduced by the fact that we have permitted it to design its rates with a full discount adjustment. Thus, El Paso's rates will be designed so that it can recover 100 percent of its cost of service, if it is required to offer the same level of discounts as it did during the test period. In addition, earlier in this order, we have granted rehearing of Opinion No. 528's requirement that El Paso use unadjusted billing determinants to allocate costs among rate zones. This holding reduces the level of costs El Paso must allocate to its California zone, where it faces the most competition.

326. In its rehearing request, El Paso contends that its SFV rate design and use of a discount adjustment in designing its rates should have no bearing on the determination of its relative business risk as compared to the proxy group, because those policies apply to all pipelines. The Commission disagrees. The Commission's policies requiring pipelines to use an SFV rate design and permitting pipelines to reduce their rate design volumes to reflect discounting are key reasons underlying our traditional assumption that natural gas pipelines "generally fall into a broad range of average risk absent highly unusual circumstances that indicate an anomalously high or low risk as compared to other pipelines."[524] These rate policies help mitigate the business risks faced by all pipelines, thus minimizing the differences in risk faced by pipelines absent very unusual circumstances. On rehearing, El Paso does not contest the fact that our decision permitting it to design its rates with a full discount adjustment will permit it to recover its full cost of service, if it continues to offer the same level of discounts as during the test period. Rather, it suggests that it faces a significant risk that it will be required to offer deeper discounts in the future than during the test period. However, most of the evidence El Paso has relied on to support a finding of high business risk concerns events that have already occurred, such as the decline in its throughput. El Paso's assertions that its market situation will continue to deteriorate in the future, in a manner not reflected in the test period in this case, is too speculative to justify increasing its ROE above the median in this case.

327. Since the Commission implemented its SFV rate design policies pursuant to Order No. 636, the Commission has found that a pipeline faced anomalously high business risk justifying an ROE at the top of the zone of reasonableness only once, in

[523] *Id.* P 695.

[524] Opinion No. 524, 142 FERC ¶ 61,197 at P 323 (citing *Transco*, 90 FERC ¶ 61,279 at 61,936 and other cases).

Opinion Nos. 524 and 524-A concerning Portland Natural Gas Transmission (Portland).[525] A comparison of the competitive circumstances that led the Commission to find that Portland had made a compelling case that it had anomalously high business risks, and those on which El Paso makes its claim of anomalous business risk, shows that El Paso has not come close to demonstrating the type of unusual circumstances we found in Opinion Nos. 524 and 524-A. As described in those opinions, Portland has two sets of facilities. Its Northern Facilities extend from the U.S.-Canadian border in New Hampshire to an interconnection with Maritimes and Northeast Pipeline (Maritimes) in Westbrook, Maine. Portland also has 210,840 Dth of capacity extending from Westbrook, Maine into Massachusetts on facilities jointly owned with Maritimes (Joint Facilities). The Commission held that Portland had anomalously high business risk because of the interaction of the at-risk condition established in its certificate proceeding with adverse market conditions.[526] The at-risk condition requires Portland's rates to be designed based on the 210,840 Dth capacity of Portland's Joint Facilities. However, Opinion Nos. 524 and 524-A found that Portland had lost nearly 30 percent of its contracted firm capacity commitments due to bankruptcy of the contract holders. We also noted that in the four years following the termination of those contracts, Portland had been unable to remarket any of the resulting unsubscribed capacity on a long-term firm basis. We also found that Portland's inability to market its unsubscribed capacity had been exacerbated by changes to Portland's system as a result of an expansion of the Maritimes system, resulting in Portland only being able to flow 168,000 Mcf per day on its Northern Facilities, even though its capacity on the Joint Facilities was 210,840 Dth per day and the at-risk condition is based on that capacity. The Commission found that the only method of accessing Portland's capacity on the Joint Facilities in excess of 168,000 Mcf per day is through Maritimes, but shippers on Maritimes have little incentive to contract with Portland for capacity on Portland's share of the Joint Facilities because the rates they pay Maritimes include service on the Joint Facilities and are lower than Portland's rates.[527] The Commission accordingly found that the requirement that Portland design its rates based on billing determinants that are nearly twenty percent higher than the amount it can transport increased its business risk above that of the proxy group members whose pipelines generally are not subject to such an at-risk condition and in any event do not face the same difficulties in marketing unsubscribed capacity.

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[525] Opinion No. 524-A, 150 FERC ¶ 61,107 at P 196.

[526] Opinion No. 524-A, 150 FERC ¶ 61,107 at PP 191-199.

[527] *Id.* P 197. The Commission also explained why Portland's prospects of marketing any increase in its capacity on the Northern Facilities above 168,000 Mcf are limited. P 198.

Here, as discussed above, we are allowing El Paso to design its rates with a full discount adjustment, which mitigates El Paso's risk against unsubscribed and discounted capacity. Moreover, El Paso does not face any difficulty in marketing its capacity comparable to Portland's difficulty in marketing its capacity on the Joint Facilities in excess of 168,000 Mcf.

328. Opinion Nos. 524 and 524-A also relied on an S&P credit report downgrading Portland's senior secured notes to BB+ in finding that Portland faced anomalously high risk.[528] While El Paso points out that Portland's BB+ credit rating was one step above the BB credit rating S&P has given El Paso, the S&P credit rating downgrade for Portland was based expressly on Portland's own circumstances, unlike S&P's consolidated corporate rating of El Paso discussed above. In Opinion No. 524-A, the Commission pointed out that the S&P credit report on Portland projected that Portland's revenues from the rates we approved in that case would be below those necessary to satisfy the 1.3 debt service coverage ration required in the covenants in Portland's senior secured notes. Thus, Portland's at-risk condition, combined with its adverse competitive situation, led to the Commission approving rates which would prevent Portland from making distributions to its equity investors.[529] The Commission found that this would inevitably lead an investor to consider an investment in Portland to entail significant risk. No similar circumstance exists in this case.[530]

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[528] Opinion No. 524-A, 150 FERC ¶ 61,107 at PP 209-231.

[529] *Id*. P 226.

[530] El Paso points out that it provided an exhibit purporting to compare the business risk profiles of the pipelines owned by each proxy company to El Paso's business risk. Ex. EPG-181. That exhibit is based on El Paso's proposed proxy group. As a result, it does not include pipelines owned by proxy company Spectra Corp., but it does include sixteen pipelines owned by companies which we excluded from the proxy group. Of the remaining 12 pipelines listed in that exhibit, which are owned by companies in the approved proxy group, El Paso asserts that three are high risk, six are medium risk, and three are low risk. The Commission finds that the analysis in that exhibit is contrary to the Commission policy that most pipelines fall within a broad range of average risk, given that El Paso would treat fully half the pipelines as having either high or low risk. In short, that exhibit is based on making finely calibrated business risk distinctions of the kind we have found we cannot make with any degree of accuracy. Also, implicit in that analysis is that a significant proportion of pipelines have below average risk that would justify lowering their ROEs below the median, contrary to our general practice of awarding ROEs at the median of the zone of reasonableness.

329. Thus, the Commission finds that the risks El Paso faces with respect to competition do not rise to the level that would justify a finding of anomalously high risk, as found with respect to Portland in Opinion Nos. 524 and 524-A. We now turn to El Paso's remaining contentions on this issue.

ii. Regulatory Risk

330. El Paso also argued before the Presiding Judge that the pro-competitive policies of the Commission, the ACC, and the CPUC, exacerbate El Paso's already high competitive risk. El Paso claimed that a central Commission policy focus has been to increase the nation's natural gas infrastructure, even if such infrastructure development alters the competitive landscape and negatively impacts existing pipelines and their captive/recourse rate shippers.[531] Recognizing this claim, the Presiding Judge found that while El Paso's historical investments and service obligations are relatively unaffected by the Commission policy shift in favor of competition, the shift has altered El Paso's business landscape and risks, including its ability to compete in its traditional markets and the corresponding opportunity to realize a reasonable ROE.[532] The Presiding Judge makes similar findings with regard to the competitive policies of California and Arizona. For example, he cited evidence that the CPUC has endorsed a "portfolio" theory of LDC supply management, which promotes purchasing natural gas supplies from diverse supply basins by obtaining capacity on multiple pipelines.[533] While recognizing that "the pro-competition policies embraced by the Commission, ACC and CPUC are clearly not specific or unique to [El Paso]," the Presiding Judge nevertheless concludes those policies "do have specific and unique impacts on [El Paso's] abilities to retain load, avoid further FT contract discounting & sculpting and minimize recourse rates."[534] The Presiding Judge further finds found that these impacts, coupled with El Paso's regulated status, indicate El Paso's competitive risk is materially exacerbated by its regulatory risks.

331. The Commission finds that El Paso's claim that regulation is responsible for exacerbating its competitive risks is unsupported, speculative, and fails to consider countervailing benefits of regulation. First, as the Presiding Judge correctly points out, the regulatory policies of which El Paso complains are in no manner unique or exclusive

[531] Ex. EPG-177 at 21.

[532] Initial Decision, 139 FERC ¶ 63,020 at P 53.

[533] *Id*.

[534] *Id*. (citing Tr. 3249-52).

to El Paso. The Initial Decision does not explain how El Paso is purportedly more adversely affected by such regulation, or how its circumstances are so unique as to be compensated with an ROE above the median based on the effect of El Paso being a regulated company.[535] Nor does the Initial Decision identify any evidence that regulation is to blame for El Paso's unsubscribed capacity or its discounting.

332. Moreover, the Presiding Judge's analysis ignores countervailing record evidence of the benefits of regulation to El Paso's situation. For example, one El Paso witness suggested that the California shippers' desire to obtain supplies from diverse regions could help El Paso retain shippers when their contracts expire. That witness testified, "I would be very surprised if, when their contracts expire, that they choose to turn them back, and that's predicated upon, again, having a portfolio of diverse supply connections into the basins."[536] As also discussed above, our decision that El Paso may design its rates so that they will recover 100 percent of its costs if it is required to continue offering the same discounts as during the test period helps mitigate any risks associated with its unsubscribed capacity and discounting by allocating related costs to its maximum rate customers. This finding effectively nullifies any argument that regulatory policies to which El Paso are subject "have specific and unique impacts" on El Paso's abilities to retain load and avoid further FT contract discounting and sculpting. Additionally, the record indicates that, as a result of the SFV rate design approved by the Commission, El Paso recovers approximately 95 percent of its costs for mainline transmission service through reservation rates, regardless of how much natural gas is actually shipped on its system. Given these facts, the Commission finds that El Paso has not shown that the regulatory risks it faces exacerbate its competitive risks to the extent that it renders El Paso's business risk highly unusual or anomalous.

iii. <u>Declining Throughput</u>

333. In the Initial Decision, the Presiding Judge found that El Paso had experienced a 28 percent decline in throughput between January 2009 and March 2011. The Judge also noted that 24 percent of El Paso's contract demand was up for renewal in 2011 and an additional 13 percent was up in 2012. Based on these figures, the Presiding Judge concluded that El Paso's declining throughput elevates its business risk.

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[535] As Trial Staff notes, in its Initial Brief El Paso argued that nothing in the record shows that its unsubscribed capacity "is materially different from the amount of unsubscribed capacity on other pipelines." Staff Brief on Exceptions at 45 & n.117 (citing El Paso Initial Br. at 116).

[536] Tr. 663 (Testimony of George Wayne).

334. As we noted in Opinion No. 528, this analysis essentially ignores related risk reducing factors, including El Paso's SFV rate design and ability to design its rates using a full discount adjustment, as discussed above.[537] The only risk left El Paso in this regard is the manageable one of lost or discounted capacity between rate cases, a risk that is not unique to El Paso. Moreover, as we noted in Opinion No. 528, the fact that the Commission approved a rate design methodology for El Paso that allows it to minimize the risks of unsubscribed and discounted capacity distinguishes this case from our finding in *Portland*, where the Commission found that the pipeline should receive an ROE at the top of the range of reasonable results based partially on the fact that Portland was at-risk for its unsubscribed capacity.[538]

335. Additionally, as we stated in Opinion No. 528, the Presiding Judge's finding of unusually high business risk is inconsistent with the S&P report, which specifically recognizes that the risk of El Paso's declining throughput is mitigated by the fact that El Paso recovers 89 percent of the value of that capacity through reservation charges that it collects whether or not it actually ships any natural gas.[539] Thus, as in Opinion No. 528, we find that El Paso's decline in throughput does not elevate its business risk to the level that would warrant an ROE at the top of the range of reasonable returns.

iv. <u>Average Remaining Contract Life</u>

336. The Presiding Judge adopted S&P's estimate of three years as the average remaining life on El Paso's long-term firm contracts, and thus found that El Paso's average remaining contract life is less than the five- to six-year average remaining contract life for the proxy group members.[540] This finding, however, does not warrant placing El Paso at the high end of the range of reasonable returns. The Presiding Judge's conclusion is inconsistent with record evidence that El Paso's system exhibits supply and demand diversity, which tends to decrease a pipeline's business risk.[541] Additionally, the record evidence indicates that El Paso's customers often renew their contracts; thus it is not appropriate to presume that El Paso's contracts will in fact expire in three years. According to the record, El Paso's average contract life in September 2010 was three

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[537] Opinion No. 528, 145 FERC ¶ 61,040 at PP 696-697.

[538] *Id.* P 697 & n.1026.

[539] *Id.* P 695.

[540] Initial Decision, 139 FERC ¶ 63,020 at P 50.

[541] Ex. S-12 at 160.

years, and was still three years in September 2011.[542] According to El Paso, this is because the capacity related to contracts that El Paso listed as expiring was never completely unsubscribed but was either renewed or sold to another shipper.[543]

337. Moreover, the fact that El Paso's customers may renew their contracts for shorter contract terms is not a risk that is specific to El Paso. To the contrary, that is a risk faced by all Commission regulated pipelines, and, as we have recognized previously, is due in part to the Commission's Order No. 636 policies on competition.[544] Accordingly, while El Paso's average remaining contract life of three years is less than the industry average, it is not highly unusual and does not support awarding El Paso an above average ROE.

v. <u>Sculpted Contracts</u>

338. The Presiding Judge found that the record established that El Paso had a high percentage (approximately 50 percent) of "sculpted contracts" (contracts that allow firm shippers to vary capacity entitlements by month or season to match actual demand), a situation that the Initial Decision determines is unique to El Paso.[545] The Presiding Judge also found that as a result, approximately 50 percent of El Paso's total long-term firm capacity is being subscribed on "something less than an annual basis," thus limiting El Paso to marketing the non-subscribed capacity on a short-term basis. The Presiding Judge concluded that El Paso's sculpted agreements essentially strand significant percentages of El Paso's long-term firm capacity, putting El Paso at further risk for unsubscribed or discounted capacity, and materially increasing its business risk.

339. The Commission rejects the argument that El Paso's sculpted contracts render its business risks highly unusual or anomalous. While the Commission has referred to El Paso's sculpted contracts as "unorthodox,"[546] the fact that those contracts may be unorthodox does not make El Paso unusually risky. In fact, El Paso entered into those

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[542] *See* Ex. EPG-201, Tr. 1401-02, and Ex. S-39.

[543] Tr. 1401-02.

[544] *See, e.g., Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation; and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, Order No. 636-C, 78 FERC ¶ 61,186, at 61,773-74 (1997); *see also Mojave Pipeline Co*., 81 FERC ¶ 61,150, at 61,689 (1997).

[545] Initial Decision, 139 FERC ¶ 63,020 at P 57.

[546] *El Paso Natural Gas Co*., 111 FERC ¶ 61,408, at P 35 (2005).

contracts at a time when its capacity was constrained, and their purpose was to take advantage of seasonal differences in demand among shippers so as to provide the maximum amount of firm service possible.[547] Moreover, El Paso's rates are designed based on the average of each sculpted contract shipper's 12 monthly contract demands, rather than its single peak monthly contract demand. Thus, El Paso is not placed at risk for the capacity not subscribed by a sculpted contract shipper during its off-peak period. In addition, the sculpted firm contracts provide some advantages to El Paso. For example, the reduced contract demand of the sculpted contract shippers during off-peak periods means that capacity is not available to the sculpted contract shippers for purpose of capacity release. This reduces the competition faced by El Paso when it seeks to sell that capacity on an interruptible or short-term firm basis. In short, El Paso has not shown that its sculpted contracts impose unusual business risk as compared to the proxy group members.

340. Thus, for the reasons stated above, the Commission affirms the finding in Opinion No. 528 that El Paso did not meet its burden to show highly unusual circumstances that indicate an anomalously high risk as compared to other pipelines. As discussed, the analysis in the Initial Decision finding that El Paso had highly unusual financial and business risks is flawed in numerous respects, and was properly reversed. Accordingly, El Paso's ROE should be set at the median of the range of reasonable returns in this proceeding, or 10.55 percent.

F. Power-Up Project Phase III Prudence

341. El Paso claims that the Commission erred by failing to reverse the Presiding Judge's determination that that parties are not estopped from challenging the prudence of Phase III of the Power-Up Project. While El Paso acknowledges that the Presiding Judge rejected the prudence challenges, it nevertheless objects to the ruling as an impermissible "advisory" opinion.[548] Although the Commission found in Opinion No. 528 that El Paso was not harmed by the Presiding Judge's dicta, El Paso objects to the Presiding Judge's rejection of its estoppel contention as being inconsistent with its certificate order. El Paso reiterates its contention that parties are collaterally and equitably estopped from challenging the prudence of projects that are certificated based on a finding that the capacity provided was needed to serve a pipeline's customers' existing requirements.[549]

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[547] *Id*.

[548] El Paso Rehearing at 111.

[549] Citing *Entergy Services, Inc.*, 128 FERC ¶ 63,015, at P 321 (2009); *NStar Elec. Co.*, 120 FERC ¶ 61,261, at P 33 (2007); *New Hampshire v. Maine*, 532 U.S. 742, 749

(continued...)

342. The Commission denies rehearing. Because the Commission did not decide against El Paso on the Phase III Power Up issue in Opinion No. 528 the issue is moot and El Paso is not aggrieved by the Presiding Judge's dicta on that issue.[550]

III. Remand Proceeding, Article 11.2(b) – Docket No. RP10-1398-003

343. In Opinion No. 528, the Commission found that El Paso failed to demonstrate that it satisfied the requirements of Article 11.2(b) of the 1996 Settlement which provides that the rates charged to certain settlement shippers may not include unsubscribed or discounted capacity costs related to capacity on El Paso's system in 1995.[551] To ensure that the terms of the settlement were met, the Commission remanded this proceeding to hearing to determine an appropriate means to ensure that the protected shippers do not bear the cost of unsubscribed or discounted 1995 capacity in their rates for service not otherwise covered by the 1996 Settlement.[552] The Commission stated that the parties should use the compliance filing that El Paso submits to comply with the directives of Opinion No. 528 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

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(2001); *Davis v. Wakelee*, 156 U.S. 680, 689 (1895).

[550] An Initial Decision on its own does not create biding precedent. In Opinion No. 528, the Commission reviewed El Paso's objections on brief and found the Presiding Judge's statement dicta. 145 FERC ¶ 61,040 at P 414.

[551] Opinion No. 528, 145 FERC ¶ 61,040 at P 499. Article 11.2(b) of the 1996 Settlement states,

> (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 [contract demand]/billing determinants related to the capacity described in this subparagraph (b).

[552] Opinion No. 528, 145 FERC ¶ 61,040 at P 531.

assume responsibility and the adjusted rates applicable to those contracts.[553] The Presiding Judge conducted a hearing on June 4 and June 5, 2014 addressing whether shippers protected by Article 11.2(b) would be charged the costs of unsubscribed or discounted 1995 capacity under El Paso's 2011 rate proposal in violation of the 1996 Settlement and, if so, what is an appropriate remedy. Briefs on Exceptions and Briefs Opposing Exceptions were filed by El Paso, Trial Staff, and Rate Protected Shippers on October 17 and November 6, 2014.[554]

A. Allocation of 1995 Capacity Costs Under Article 11.2(b)

Remand Decision

344. Trial Staff and Rate Protected Shippers argued that El Paso failed to demonstrate that it had not shifted prohibited costs to its Article 11.2(b) shippers. They argued that the fact that El Paso's discounted capacity far exceeds its post-1995 capacity demonstrates that a portion of the discount adjustments related to the discounted capacity represents prohibited costs that have been shifted to Article 11.2(b) shippers. They further argued that El Paso did not show that it had voluntarily absorbed those prohibited costs. El Paso disagreed, arguing that it had not shifted such prohibited costs.

345. The Presiding Judge agreed with Trial Staff and Rate Protected Shippers that El Paso has proposed to shift costs related to the 1995 capacity in a manner that is inconsistent with Article 11.2(b) of the 1996 Settlement. The Presiding Judge found that El Paso has the initial burden of proof to demonstrate that it has not shifted prohibited costs to Article 11.2(b) shippers. The Presiding Judge found that El Paso failed to meet its burden to show that its 2011 rate proposal did not assign costs of discounted or unsubscribed capacity to Article 11.2(b) shippers as required by the 1996 Settlement. Furthermore, the Presiding Judge found El Paso's cost and revenue study to be flawed in that El Paso failed to calculate the costs of its 1995 capacity as it used the cost of the facilities comprising the 1995 system as the cost of the 1995 capacity despite the fact that it operates an integrated system that cannot be physically separated into pre-1995 or post-1995 capacity. Thus, the Presiding Judge stated that El Paso failed to comply with Article 11.2(b) which prohibits the shifting of "any cost, charge, surcharge, component, or add-on in any way related to the capacity of its system on December 31, 1995."[555] The

[553] El Paso submitted its Compliance Filing on December 16, 2013.

[554] SoCal Gas/San Diego filed a Brief on Exceptions incorporating by reference exceptions numbers one through seven and nine through twenty-one in the Brief on Exceptions filed by El Paso.

[555] March 20 Order, 114 FERC ¶ 61,290 at P 60; September 5 Order, 124 FERC

(continued...)

Presiding Judge found Trial Staff and Rate Protected Shippers to have both demonstrated shifting of prohibited costs to Article 11.2(b) shippers.[556]

Briefs on Exceptions

El Paso

346. El Paso argues that the Presiding Judge erred by rejecting its cost and revenue analysis remaining in the record after El Paso's initial analysis was stricken.[557] El Paso claims it properly submitted a different and more limited cost and revenue analysis in its rebuttal testimony and its study is largely unchallenged in the record. El Paso states the Presiding Judge did not reject or challenge the calculations of the costs or revenues relating to 1995 capacity included in El Paso's study nor find that El Paso failed to adequately address the impact of the discount adjustment on the revenues counted in the study, as the Commission required in Opinion No. 528.[558]

347. El Paso states the Commission routinely performs cost and revenue analyses to determine if there has been a cost shift from one class of service or shipper to another, as when the Commission wishes to determine whether the cost of expansion facilities can be rolled-in to existing rates, pursuant to the Commission's Certificate Policy Statement. El Paso states that to determine whether there is a shift in the cost of unsubscribed or discounted 1995 capacity in the rates of Article 11.2(b) shippers, the costs of the 1995 capacity in the compliance rates filed by El Paso in this case must be ascertained and compared to revenues El Paso receives to assess whether such revenues cover the cost of the 1995 capacity. El Paso contends that the costs shifted through the discount adjustment are related to capacity that El Paso constructed after 1995 and not to 1995 capacity.

348. El Paso calculates the depreciated cost of 1995 capacity in El Paso's recourse rates to be $221 million. El Paso calculates the revenues attributable to 1995 capacity to be almost $480 million. El Paso argues that the rationale underlying the threshold

¶ 61,227 at P 98; *aff'd*, *Freeport*, 669 F.3d 302.

[556] Remand Decision, 148 FERC ¶ 63,014 at PP 107-116.

[557] *El Paso Natural Gas Co.*, Order Granting in Part and Denying in Part Motions to Strike Testimony and Exhibits, Docket No. RP10-1398-003 (Feb. 26, 2014) (Dowd, Presiding Judge) (February 26 Order).

[558] El Paso Brief on Exceptions at 22-23.

presumption – that the highest rate contracts are attributable to 1995 capacity - applies to its calculation of the revenues attributable to 1995 capacity, and calculates the revenues from firm contracts priced at or above the Article 11.2(a) rates to be $413 million based on that rationale. Extending that rationale to discounted contracts, El Paso attributes the highest rate discount contracts to the remaining 1995 capacity, adding $48 million. Finally, El Paso calculates the pro-rata share of its $20 million interruptible revenues attributable to 1995 capacity to be $17.5 million.[559] El Paso thus calculates the total revenues attributable to 1995 capacity to be $478.5 million, which exceed the cost of 1995 capacity of $221 million. El Paso further argues that because the cost of post-1995 capacity ($174 million) greatly exceeds the discounted costs shifted through the discount adjustment ($73 million), none of the costs shifted through the discount adjustment are related to 1995 capacity. Thus, El Paso claims that the Presiding Judge erred by finding that costs of unsubscribed or discounted 1995 capacity have been shifted to Article 11.2(b) shippers.[560]

349. El Paso argues that the 1996 Settlement did not insulate shippers from the costs to improve the service they received, such as expenditures to maintain, upgrade, enhance or replace parts of its system. El Paso maintains that this is especially true with respect to El Paso's Pipeline Integrity Program (PIP) costs – which it characterizes as being largely incurred pursuant to legislation and regulations that did not exist in 1995 and could not have been contemplated at the time. El Paso asserts that, even if a portion of these costs is attributed to 1995 capacity, El Paso's revenues still exceed these higher costs.[561]

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[559] El Paso calculates the ratio based on 1995 capacity (4,000 MMcf/d) compared to the post-1995 capacity (550 MMcf/d). Thus, 4,000 + 550 = 4,550 MMcf/d (total capacity) and 4,000 ÷ 4,550 = 88% (portion of total capacity representing 1995 capacity). 88% of $20 million system IT revenues = $17.5 million (amount El Paso attributes to 1995 capacity).

[560] El Paso Brief on Exceptions at 23-29.

[561] El Paso Brief on Exceptions at 30-32. To support this assertion, El Paso departs from the 88/12 ratio of 1995 to post-1995 capacity (4,000 vs. 550 of 4,550 MMcf/d total system capacity) that it uses to calculate IT revenue to be credited against 1995 capacity costs. *See* El Paso Brief on Exceptions at 59; Ex. 16R 46-47. Instead for its revenue test, El Paso calculates the ratio of 1995 costs to the post-1995 costs by first subtracting PIP, maintenance and incrementally-priced Willcox lateral costs from its total cost of service, arriving at $327 million. El Paso compares this $327 million adjusted total system capacity cost figure to the $221 million figure, representing 1995 cost of service adjusted for depreciation and retirements. Dividing $221 million by $327 million results in a 67% ratio of depreciated 1995 costs to adjusted total system

(continued...)

350. El Paso states the Presiding Judge also erred by finding that El Paso's cost and revenue study is flawed because it measures the cost of El Paso's 1995 facilities, as opposed to 1995 capacity. El Paso states the cost of capacity can be measured only by reference to the cost of facilities that create that capacity. El Paso adds that the Remand Decision does not explain how the cost of capacity can otherwise be determined.[562]

351. El Paso argues that the Presiding Judge erred by finding that El Paso's cost and revenue analysis constitutes prohibited relitigation. El Paso argues to the contrary that the Commission did not, in Opinion No. 528, prohibit El Paso from proposing a cost and revenue analysis that addresses the concerns raised with its prior study. El Paso objects to the February 26 Order which struck the cost and revenue analysis, arguing that the Commission's rejection in Opinion No. 528 of a "bifurcated" cost of service and its directive to use a single cost of service in the Compliance Filing were in response to issues related to Article 11.2(a), not Article 11.2(b).[563]

352. El Paso contests the Presiding Judge's finding that Trial Staff demonstrated a shift in unsubscribed or discounted 1995 capacity costs in El Paso's current rates. El Paso claims that this contention is flawed because it does not take into account the cost of 1995 capacity in El Paso's current rates and does not distinguish between 1995 and post-1995 costs. El Paso contends that Trial Staff never answers whether there are costs of unsubscribed or discounted 1995 capacity shifted to these rates, but rather Trial Staff

costs, which El Paso applies to total maintenance and PIP costs, arriving at $140 million in potential additions to 1995 capacity costs (if its original assessment of not including maintenance and PIP costs is rejected). El Paso thus calculates the total 1995 cost to be $361 million ($221 million depreciated cost plus $140 million share of maintenance and PIP costs). El Paso compares this $361 million cost figure to the $406 million in revenues it states are derived from 1995 capacity ($461 million in firm revenues plus $17.5 million in interruptible revenues (using the 88% ratio) minus $73 million discount adjustment costs (assuming highest discounted rates apply primarily to post-1995 capacity) to arrive at $406 million. *See also* Ex. EPG-46R and 47R for the underlying calculations. Because $406 million in revenues attributable to 1995 capacity under these calculations is greater than $361 million in costs attributed to 1995 capacity, El Paso finds no cost shift.

[562] El Paso Brief on Exceptions at 37-40.

[563] *Id.* at 49 (citing February 26 Order, Docket No. RP10-1398-003 at PP 22-25).

assumes there are costs of unsubscribed or discounted 1995 capacity that must be excluded from El Paso rates because the presumption is not met.[564]

353. El Paso objects to the notion that there is automatically an impermissible cost shift in its rates when the 4,000 MMcf/d presumption is not met. According to El Paso, such an assumption (a) is contrary to the express holdings of Opinion No. 528, (b) is contradicted by other parts of the testimony submitted by Rate Protected Shippers witness Mr. Lander, and (c) misconstrues the nature and purpose of the presumption. El Paso states that the Commission clearly set not one, but two, issues for hearing. El Paso maintains the only way to determine a shift in the cost of 1995 capacity to El Paso's recourse rates is to identify the cost of the 1995 capacity and determine whether any of those costs are being shifted to the current rates.[565]

<u>Briefs Opposing Exceptions</u>

Trial Staff

354. Trial Staff contests El Paso's claim that Trial Staff "automatically" assumed that there is a cost shift to Article 11.2(b) customers. Trial Staff explains that the existence of a shortfall (when the threshold is not met) indicates that there is unsubscribed or discounted 1995 capacity; however, a cost shift occurs if the costs of discount adjustments for discounted or unsubscribed 1995 capacity are included in the maximum recourse rates of Article 11.2(b) shippers. Trial Staff proposes that El Paso's Compliance Filing must be scrutinized to determine whether improper costs should be removed from Article 11.2(b) shippers' rates.[566] Trial Staff defends this process as an affirmative demonstration that there is a cost shift, as opposed to an assumption. Trial Staff states that it did not attempt to distinguish El Paso's 1995 and post-1995 facility costs because it is inappropriate to segregate the costs of the undifferentiated capacity on El Paso's integrated system.

355. Trial Staff argues that El Paso's cost and revenue study is an attempt to relitigate the Commission's prior finding that El Paso had not met the Article 11.2(b) presumption. According to Trial Staff, El Paso admits that the studies in its direct and rebuttal

[564] *Id.* at 52-54.

[565] *Id.* at 54-58.

[566] Trial Staff Brief Opposing Exceptions at 15 (citing Ex. S-4R at 6).

testimony are intended to address the Commission's concerns with its original cost and revenue study and thereby acknowledges that the issue is being relitigated.[567] Trial Staff argues that, contrary to El Paso's claim, the remand proceeding is not an invitation to resubmit a corrected cost and revenue study to show compliance with Article 11.2(b). The Commission remanded the proceeding because the record was inadequate and incomplete since the remedy testimony had been struck by the Presiding Judge in Phase I of the proceeding. Trial Staff characterizes El Paso's concern as objecting to the Commission's having already rejected the only methodology it proffered to avoid its Article 11.2(b) obligations.[568]

356. Trial Staff argues that the assumptions underlying El Paso's cost and revenue study are incompatible with Commission findings that El Paso's system is integrated and that it markets undifferentiated capacity. Trial Staff states that El Paso's cost and revenue study is based on an inappropriate assumption that the costs and associated revenues of its 1995 facilities should be extracted from its cost of service. Trial Staff argues that El Paso's cost and revenue approach is not supported by its analogy to certificate proceedings, for the Commission has expressly rejected El Paso's prior attempt to separate its system capacity by vintage for Article 11.2 purposes.[569] Furthermore, Trial Staff argues that El Paso's cost and revenue analysis is improper because it essentially uses a bifurcated cost of service, contrary to Opinion No. 528.[570]

357. Trial Staff argues that El Paso's study inappropriately uses facilities costs extracted from its cost of service to measure capacity costs. Trial Staff urges the Commission to affirm the Presiding Judge's finding that the cost of capacity does not refer solely to the cost of specific facilities comprising El Paso's 1995 system because the capacity on the integrated El Paso system and the associated costs and revenues are undifferentiated. Trial Staff argues that to determine any improper cost shift to

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[567] *Id.* at 18 (citing El Paso Brief on Exceptions at 41).

[568] *Id.* at 17-21.

[569] *Id.* at 23-24 (citing Opinion No. 517, 139 FERC ¶ 61,095 at P 300; September 5 Order, 124 FERC ¶ 61,227 at P 98; Opinion No. 528, 145 FERC ¶ 61,040 at PP 469, 473, 490-98).

[570] *Id.* at 24 n.16 (citing Opinion No. 528, 145 FERC ¶ 61,040 at PP 473, 480, 490-498 (rejecting El Paso's proposed bifurcated cost of service wherein El Paso proposed a separate cost of service for Article 11.2(a) service and for non-Article 11.2(a) service by allocating the 1995 costs to both services and the post-1995 costs only to non-Article 11.2(a) service)).

Article 11.2(b) shippers entails identifying costs related to unsubscribed or discounted undifferentiated 1995 capacity, as Article 11.2(b) requires, rather than the costs of discrete facilities. Trial Staff argues that El Paso's system is integrated so that all dollars in its cost of service represent both 1995 and post-1995 costs, all revenue dollars recover both 1995 and post-1995 costs, and all discount revenues are based on both 1995 and post-1995 capacity.[571]

358. Trial Staff argues that El Paso's claim that its rebuttal cost and revenue study is "unrebutted" should be rejected. Trial Staff and Rate Protected Shippers had no opportunity to file testimony addressing the deficiencies of that study, but did conduct cross examination, introduced El Paso's discovery responses into the record, and filed briefs demonstrating that El Paso's cost and revenue analysis is invalidated by numerous arbitrary and unsupported assumptions.[572]

359. Trial Staff explains how El Paso's flawed analyses are invalidated by inappropriate assumptions and unreliable estimates of 1995 capacity costs. Trial Staff notes that El Paso's proposed cost of service is based on depreciated 1995 Gross Plant in Service and does not include any expenditures El Paso incurred after December 31, 1995 for maintenance, safety or reliability upgrades, PIP costs, or to replace the 1995 facilities, contrary to Article 11.2(b)'s requirement that shippers be protected from "any cost, charge, surcharge, component, or add-on in any way related to the capacity of its system on December 31, 1995."[573] In addition, El Paso did not identify 1995 facilities but instead simply derived a rate base for 1995 facilities using data from El Paso's 1995 FERC Form No. 2. In addition, Trial Staff notes that El Paso did not directly assign operation and maintenance costs to the 1995 system cost of service, but instead used an allocation. Trial Staff argues that El Paso's cost and revenue analysis overstates revenues for 1995 capacity and discounts from post-1995 capacity. In addition, Trial Staff argues that El Paso fails to consider the billing determinants used and the revenues derived from each set of shippers.[574]

360. Trial Staff argues that El Paso's Compliance Filing reflects an annual average maximum daily quantity of all discounted firm contracts of more than 1,500,000 Dth/d whereas El Paso's post-1995 expansion capacity is only 550 Dth/d, which demonstrates

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[571] Trial Staff Brief Opposing Exceptions at 25-27.

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

[573] *Id.* at 26 & n.18 (citing Article 11.2(b)).

[574] Trial Staff Brief Opposing Exceptions at 29-34 (citing multiple exhibits).

that post-1995 capacity accounted for only one third of the discounted capacity, not the full amount that El Paso argues.[575]

361. Trial Staff argues that El Paso fails to demonstrate on exceptions that there is no cost shift, even if PIP costs are included and discount adjustment revenues are excluded. Trial Staff objects to El Paso's assumption that only two-thirds of PIP and maintenance costs are attributable to the 1995 facilities as unsupported and likely understated because it is based on a percentage of El Paso's improperly extracted 1995 facilities' cost level. Trial Staff further claims that the assumption is inconsistent with El Paso's ratio of 1995 capacity to total system capacity of approximately 88 percent that underlies El Paso's interruptible revenue calculation. Trial Staff contends that El Paso fails to demonstrate how the PIP costs correlate to the cost of service rather than the length of pipe and physical attributes of the facilities, such as age and location.[576] Trial Staff criticizes El Paso's assumption that PIP costs should be attributed to a particular customer's service by contract (i.e., not to Article 11.2(b) contracts as a whole), rather than by the length of pipe and physical attributes of the facilities, in particular the age and location of the pipeline.[577] Trial Staff further argues that El Paso improperly attributes the highest revenue contracts to 1995 capacity based on the unsupported conclusion that if El Paso had not incurred post-1995 expansion costs, its costs and rates would be lower and its need to discount less. In addition, Trial Staff contends El Paso failed to reduce 1995 revenues by the $73 million in discounts shifted to its rates through the discount adjustment approved in Opinion No. 528.[578]

Rate Protected Shippers

362. Rate Protected Shippers agree the Presiding Judge correctly concluded that El Paso's primary case was a relitigation of its failure to comply with Article 11.2(b). El Paso is the only party to argue that its revised cost and revenue study is required to determine compliance with Article 11.2(b). Rate Protected Shippers state that they and Trial Staff believe that the Commission's findings in Opinion No. 528 regarding El Paso's failure to meet the threshold, combined with the Compliance Filing and El Paso's failure to remove costs for discounts from the rates of protected Article 11.2(b)

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

[576] *Id.* at 35.

[577] *Id.*

[578] Trial Staff Brief Opposing Exceptions at 34-35.

shippers therein, demonstrate that El Paso's compliance rates for Article 11.2(b) shippers include prohibited costs.[579]

363. In response to El Paso's assertions that Article 11.2(b) compliance relies on a demonstration that El Paso generates sufficient revenues to cover the cost of the 1995 system facilities in its current rates, Rate Protected Shippers argue that El Paso's contentions ignore (a) the Commission's determination in Opinion No. 528 that El Paso has not met the threshold, (b) Commission findings on the integrated nature of El Paso's system, (c) the fact that 1995 capacity on El Paso's system is not traceable, and (d) the fact that El Paso has greater capacity quantities discounted below the Article 11.2(a) rate than it has 1995 capacity quantities. Rate Protected Shippers assert there is simply no question that a large amount of these discounted quantities reflects rates for capacity sold below Article 11.2(a) rates.[580]

364. Rate Protected Shippers object to El Paso's claim that the cost shift is assumed merely because El Paso failed to satisfy the threshold presumption. Rate Protected Shippers argue that, in the Compliance Filing, El Paso allocated the discount adjustment for short-term firm rate discounts to the rates of all maximum recourse rate shippers, across all zones and all firm shippers, including Article 11.2(b) shippers. Additionally, Rate Protected Shippers allege that in some zones, e.g., California, El Paso allocated the costs of its substantial long-term firm rate discounts to the rates of Article 11.2(b) shippers. Rate Protected Shippers contend that El Paso did not attempt to protect Article 11.2(b) shippers by voluntarily eliminating or absorbing the discounted capacity costs improperly allocated to such shippers via its compliance rates.[581]

365. Rate Protected Shippers argue they and Trial Staff demonstrated that El Paso's compliance rates include the cost of discount adjustments, including prohibited costs in every zone. Rate Protected Shippers assert they both show that 1,564,972 Dth/d of system discounted capacity is priced below Article 11.2(a) rates and that some of these discounts must be 1995 capacity. Rate Protected Shippers point out when following El Paso's logic, but looking at capacity quantities instead of El Paso's contrived post-1995 facilities cost of service, if El Paso's total discount-adjustment capacity quantities priced below the Article 11.2(a) rates are more than El Paso's post-1995 expansion capacity

[579] Rate Protected Shippers Brief Opposing Exceptions at 7-9.

[580] *Id.* at 10-12 (citing Ex. RPS-94R, column d, lines 41, 48; Opinion No. 528, 145 FERC ¶ 61,040 at P 530).

[581] *Id.* at 12-13 (citing Ex. RPS-1R at 17-18; Ex. SWG-1R at 12; Ex. EPG-1R at 18).

quantities, then some of those discount-adjustment capacity quantities must be associated with 1995 capacity. Since El Paso's 1,564,972 Dth/d of total discount-adjustment capacity quantities priced below the Article 11.2(a) rates far exceeds El Paso's 559,350 Dth/d of post-1995 mainline expansion capacity quantities, Rate Protected Shippers maintain it is clear that more than 1,000,000 Dth/d of 1995 capacity is discounted and that El Paso has allocated a large portion of its discounted 1995 contract costs to the maximum recourse rates of Article 11.2(b) shippers.[582]

366. Rate Protected Shippers state, as a general principle, that an Article 11.2(b) shipper is paying prohibited costs in violation of the 1996 Settlement whenever (a) El Paso fails to meet the threshold; (b) the Article 11.2(b) shipper pays a portion of El Paso's total long-term firm and short-term firm discount adjustments as part of its rates; and (c) El Paso fails to absorb the portion of the discount adjustments paid by Article 11.2(b) shippers that is associated with the shortfall below the threshold adopted by the Commission. Rate Protected Shippers claim all three of these elements are present here.[583]

367. According to Rate Protected Shippers, the Commission already determined that it is not possible to distinguish 1995 capacity from post-1995 capacity and that El Paso's attempts to quantify the costs of the integrated capacity separately by vintage of facilities should be rejected because they are inconsistent with prior Commission pronouncements. Rate Protected Shippers contend that, for the same reasons that the Commission determined that it was not reasonable to track 1995 capacity, it is not reasonable to track 1995 facilities' costs. In Article 11.2(b), El Paso agreed to exclude from the rates of Article 11.2(b) shippers "any cost, charge, surcharge, component, or add-on in any way related to the capacity of its system on December 31, 1995, to deliver [natural] gas." Rate Protected Shippers state the Commission found this relationship is confounded by capacity additions after 1995 to El Paso's integrated system, so it established the threshold at the approximate level of 1995 capacity for the purpose of determining Article 11.2(b) compliance. Rate Protected Shippers argue that because utilization of 1995 capacity cannot be distinguished, it follows that costs related to that capacity also cannot be identified. Rate Protected Shippers contend that El Paso's attempt to separate

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[582] *Id.* at 14-15 (citing Tr. 84; Ex. RPS-1R at 9, 19; Ex. S-1R at 6, 14; Ex. SWG-1R at 8, 9-10). Rate Protected Shippers state that there is no dispute that El Paso's total discount-adjustment capacity quantities priced below the Article 11.2(a) rates are 1,564,972 Dth/d (citing Tr. 84 (Rezendes)).

[583] Rate Protected Shippers Brief Opposing Exceptions at 16-17.

the costs of its 1995 facilities from its post-1995 facilities is an attempt to circumvent this determination that the costs of 1995 and post-1995 capacity cannot be distinguished.[584]

368. Rate Protected Shippers assert El Paso relies upon a strained reading of Opinion No. 528 when it argues that it is entitled to submit its cost and revenue study. Opinion No. 528 states,

> 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 amounts are sufficient to ensure that Article 11.2(b) shippers are not being allocated costs attributable to discounted or unsubscribed 1995 capacity.[585]

Rate Protected Shippers state that this was not an invitation for El Paso to resubmit its cost and revenue study. Rate Protected Shippers argue that, despite El Paso's protestations, its cost and revenue study is not necessary to respond to whether shippers protected by Article 11.2(b) would be charged costs of unsubscribed or discounted capacity as defined in the 1996 Settlement. Rate Protected Shippers contend El Paso's bifurcated cost of service and supporting testimony ignore the Commission's previous ruling that El Paso markets "undifferentiated capacity which cannot be physically attributed to pre-1995 or post-1995 capacity."[586]

369. Rate Protected Shippers urge the Commission to disregard El Paso's equitable factors. Rate Protected Shippers state El Paso's testimony and exhibit on this issue were stricken because the Commission did not remand this issue for consideration and they represent improper relitigation. Rate Protected Shippers state El Paso made these same arguments on more than one occasion and each time the Commission rejected them. Thus, Rate Protected Shippers argue that this argument is beyond the scope of the remand and should be rejected.[587]

<u>Commission Determination</u>

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[584] *Id.* at 22-26 (citing Opinion No. 528, 145 FERC ¶ 61,040 at P 492; September 5 Order, 124 FERC ¶ 61,227 at P 98).

[585] *Id.* at 26 (citing Opinion No. 528, 145 FERC ¶ 61,040 at P 530).

[586] *Id.* at 26-28 (citing September 5 Order, 124 FERC ¶ 61,227 at P 98).

[587] *Id.* at 31-33 (citing Opinion No. 528, 145 FERC ¶ 61,040 at P 450).

370. The Commission affirms the Presiding Judge's finding that El Paso's filed 2011 rate proposal would shift costs of 1995 capacity to protected shippers in a manner that is inconsistent with Article 11.2(b) of the 1996 Settlement. Due to the fact that El Paso operates an integrated system, the Commission established a presumption threshold that if El Paso has 4,068,000 Dth/d (the thermal equivalent of 4,000 MMcf/d) of capacity subscribed at the Article 11.2(a) rate cap or above, then El Paso has no 1995 stranded or discounted capacity.[588] In Opinion No. 517, however, the Commission stated that the presumption is not the only way to determine compliance with Article 11.2(b).[589] In both the main 2011 rate case proceeding reviewed in Opinion No. 528 and the remand proceeding established to address issues related specifically to Article 11.2(b), El Paso provided a cost and revenue study and claimed that comparing the 1995 cost of facilities with system revenues should be an appropriate and acceptable approach to determine whether it has shifted costs of unsubscribed or discounted 1995 capacity to Article 11.2(b) shippers. In the alternative, El Paso proposes to use cost and revenue data to demonstrate that it has met the 4,000 MMcf/d threshold, if certain revenues are treated as proportionate stand-ins for firm, maximum recourse rate equivalents.[590] El Paso further argues that its cost and revenue study demonstrates that no unsubscribed or discounted costs of 1995 capacity would be shifted to Article 11.2(b) rates under its 2011 rate proposal.

371. El Paso cites the Commission's Certificate Policy Statement, under which the Commission uses cost and revenue studies to analyze whether existing shippers are being asked to subsidize an expansion.[591] El Paso claims that a cost and revenue study is routinely performed pursuant to the Certificate Policy Statement to determine whether the project revenues exceed project costs and whether the cost of expansion facilities can be rolled-in to existing rates or priced incrementally to avoid subsidization by existing shippers.[592] El Paso further states that the Commission has utilized this policy regardless

[588] March 20 Order, 114 FERC ¶ 61,290, *aff'd Freeport*, 669 F.3d 302.

[589] Opinion No. 517, 139 FERC ¶ 61,095 at P 323.

[590] El Paso Brief on Exceptions at 59-60.

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

[592] *Id*. (quoting *Certification of New Interstate Natural Gas Pipeline Facilities*, 90 FERC ¶ 61,128, at 61,390 (2000) (order on clarification)).

of whether the pipeline's existing system is integrated, or has rolled-in or incremental rates.[593]

372. The Commission finds El Paso's Certificate Policy Statement analogy does not support its use of a cost and revenue study. In these certificate proceedings, the Commission's findings are only predeterminations. The analysis is based on estimated figures which may change and are not binding on any party. The instant proceeding is not a certificate proceeding but a proceeding to determine compliance with a settlement provision. Furthermore, the Commission has rejected El Paso's prior attempts to separate its capacity by vintage for Article 11.2 purposes.[594]

373. The Commission finds that El Paso's cost and revenue study is flawed in many ways. 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 [natural] 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 [contract demand]/billing determinants related to the capacity described in this subparagraph (b).

374. El Paso incorrectly interprets the costs of 1995 *capacity* as consisting exclusively of the cost of *facilities* comprising El Paso's 1995 system. The Commission's previous determinations focus on the difficulty that arises because Article 11.2(b) is silent as to how particular facilities or the cost of facilities should be addressed as a way to determine capacity.[595] The Commission therefore derived the presumption that the first

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[593] *Id*. at 8.

[594] *E.g.*, Opinion No. 528 , 145 FERC ¶ 61,040 at PP 491-493 (finding that El Paso failed to support assertions that Article 11.2 services are separable from similar services and incur only 1995 costs); Opinion No. 517, 139 FERC ¶ 61,095 at P 300 (rejecting vintage rate analogy in evaluating El Paso's shortfall recovery proposal).

[595] September 5 Order, 124 FERC ¶ 61,227 at P 97 ("El Paso operates its system on an integrated basis, and thus uses all its facilities, both old and new, to serve the

(continued...)

4,000 MMcf/d of firm subscribed capacity is El Paso's 1995 system capacity to simplify compliance with Article 11.2(b) "while preserving the protections inherent in the Article." The Commission found that this 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."[596]

375. The Presiding Judge noted that Article 11.2(b) prohibits shifting of costs "in any way related" to the 1995 capacity. Thus, as the Presiding Judge correctly found, Article 11.2(b) explicitly includes more than just 1995 facility costs that El Paso may not include in the rates charged Article 11.2(b) shippers; it also includes "any cost, charge, surcharge, component, or add-on in any way related to the capacity of its system on December 31, 1995."[597] Based on its review of the parties' understanding when they executed the 1996 Settlement, the Commission determined in the *March 20 Order* that the capacity of the El Paso system on that date was 4,000 MMcf/d.

376. El Paso estimates the depreciated cost of its 1995 facilities at $221 million. However, El Paso derived this figure using 1995 Form 2 data.[598] Contrary to the approach adopted in the 2011 Rate Case, where post-1995 maintenance and PIP costs were treated as 1995 capacity costs, El Paso's proposal would exclude expenditures to maintain, upgrade, enhance or replace parts of its system, which occurred after 1995, including PIP costs – which it characterizes as being largely incurred pursuant to legislation and regulations that did not exist in 1995 and could not have been contemplated at the time.[599] Other than by reference to 1995 Form No. 2 aggregated

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demands of all its customers. However, because Article 11.2(b) only protects eligible shippers from an allocation of costs related to unsubscribed or discounted 1995 capacity, implementation of that Article requires a determination of whether any such costs should be attributable to 1995 or expansion capacity").

[596] *Id.* P 98.

[597] Remand Decision, 148 FERC ¶ 63,014 at P 112.

[598] Ex. RPS-16R (El Paso data response).

[599] *Compare* Ex. EPG -107 at 7-8 (Rezendes defining 1995 capacity costs to include all system costs at the time of the 1996 Settlement "plus costs incurred after that time except for the costs of the major projects," which added costs "consist primarily of Pipeline Integrity Program [PIP] costs and the costs of maintaining the system known as Maintenance costs") and Ex. EPG-16R at 16-17 (Rezendes describing 1995 capacity costs as 1995 facility costs less depreciation and retirements).

data, El Paso fails to support its assertion that 1995 capacity costs consist exclusively of the costs of 1995 facilities adjusted for depreciation or to demonstrate the parties to the 1996 Settlement would not make the common sense determination to include costs to maintain, replace or repair the facilities needed to be able to provide service at 1995 capacity. Such costs must certainly be accounted for in any determination of costs "in any way related to" 1995 system capacity under the 1996 Settlement. If costs relating to 1995 system capacity do not include costs to maintain service at the 1995 capacity levels, then one would expect the capacity costs referred to in Article 11.2(b) to fall over time. The Commission implicitly rejected such an approach when it established in the March 20 Order the 4,000 MMcf/d threshold based on the settling parties' understanding of the capacity on El Paso's system in 1995.

377. El Paso asserts that, even if a portion of these costs is attributed to 1995 capacity, El Paso's revenues still exceed these higher costs.[600] Even assuming that facilities constructed before 1995 and those constructed or acquired after 1995 can be accurately identified, El Paso admits it may not be possible to identify capacity used on any day as being created by 1995 or post-1995 facilities due to the integrated nature of El Paso's system.[601] Both Trial Staff and Rate Protected Shippers have distinguished the cost of capacity and the cost of facilities as separate items.[602] El Paso argues the fact that it operates an integrated system does not preclude a computation of the cost of the 1995 capacity in its current rates.[603] We find that El Paso has failed to provide such a showing in this case. El Paso operates an integrated system. As Trial Staff argues, all of El Paso's capacity, its cost of service and associated costs and revenues, are based on both 1995 and post-1995 capacity.

378. El Paso attempts to extract 1995 facility costs from its cost of service by submitting a revised cost and revenue study. However, this study suffers from the same failings as the one rejected in Opinion No. 528. El Paso's cost and revenue study bases the cost of service of its 1995 facilities on the bifurcated cost of service rejected by the Commission in Opinion No. 528, despite the Commission's bar on relitigation. Furthermore, as Trial Staff enumerates, El Paso's analyses are based on numerous inappropriate assumptions and unreliable estimates of 1995 capacity costs. Both cost and

[600] El Paso Brief on Exceptions at 30.

[601] Remand Decision, 148 FERC ¶ 63,014 at P 112 (citing Trial Staff Initial Br. at 22; Ex. S-7R (El Paso data response); Ex. S-9R; Ex. RPS-18R).

[602] *Id.* P 110 (citing Trial Staff Initial Br. at 8-9; RPS Initial Br. at 19-20).

[603] El Paso Brief on Exceptions at 33.

revenue studies submitted by El Paso erroneously identify the cost of 1995 *capacity* as the cost of the *facilities* comprising El Paso's 1995 system. El Paso developed a 1995 cost of service based on depreciated 1995 Gross Plant in Service, but improperly excluded any expenditures El Paso incurred after 1995 for maintenance, safety or reliability upgrades, PIP costs or to replace the 1995 facilities. In addition, El Paso's 1995 facilities' rate base was derived using its aggregated 1995 FERC Form No. 2 and did not directly assign operation and maintenance costs to the 1995 system cost of service, but instead used an allocation. As for the revenues, El Paso improperly attributed all discounts to post-1995 capacity.[604] In addition, El Paso attributed a pro rata share of its interruptible revenues to 1995 capacity even though interruptible revenues are already included in its Compliance Filing rates through a revenue credit.

379. In Opinion No. 528, the Commission rejected El Paso's revenue and volume study, stating that it lacked sufficient detail to demonstrate 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.[605] El Paso's revised study does not correct this deficiency. El Paso's current revenue study looks at total sales and revenue volumes and claims that certain 1995 costs are, in the whole, covered by the revenues. However, El Paso provides no current accounting that identifies the facilities that supported the capacity on its system in 1995, nor identifies any accounting that would track the maintenance, repair or replacement costs necessary to maintain the ability to provide capacity. The fact that El Paso lacks a sound foundation for its proposed cost accounting for 1995 facilities is dramatically underscored by the fact that, at an earlier stage in this proceeding, it proposed that <u>all</u> post-1995 maintenance as well as all pipeline safety (Pipeline Integrity Program, or PIP) costs be attributed to 1995 facility costs.[606] When El Paso was trying to shift the Article 11.2 shortfall to non-Article 11.2 shippers and minimize unrecoverable costs, it used the bifurcated cost of service proposal to maximize 1995 facility costs by attributing those post-1995 maintenance and PIP costs to the 1995 facility costs in an apparent attempt to minimize the portion of the shortfall it might be

[604] Trial Staff Brief Opposing Exceptions at 31-32 (quoting Ms. Rezendes "if [El Paso] never incurred [expansion] costs after 1995 to enhance and expand its system, its cost and rates would be lower and its need to discount would be less." Ex. EPG-16R at 39-40).

[605] Opinion No. 528, 145 FERC ¶ 61,040 at P 526.

[606] *See* Opinion No. 528, 145 FERC ¶ 61,040 at P 480 n.703; El Paso Initial Br. at 178-179.

required to absorb.[607] Now that it needs to show that revenues exceed 1995 costs, it declares that 1995 costs do not include such post-1995 costs. At a minimum, this contradiction underscores the deficiencies in El Paso's "kitchen sink" approach to rate litigation and undercuts the validity of El Paso's position. Consequently, the Commission finds that El Paso has been unable to provide an accurate and reliable assessment of costs attributable to the capacity of its system in 1995.

380. The Commission notes its agreement with Rate Protected Shippers' argument that a simple comparison of discounted capacity and post-1995 capacity reveals the existence of prohibited costs. The fact that 1,564,972 Dth/d of discounted capacity priced below the Article 11.2(a) rates exceeds the 559,350 Dth/d of post-1995 capacity demonstrates that more than 1,000,000 Dth of 1995 capacity is discounted.[608] The Commission in Opinion No. 528 also voiced its concern that the substantial discount adjustment being affirmed in the rate proceeding bore the risk that the discounts would include costs of 1995 capacity in violation of Article 11.2(b).[609] It is worth noting that the requested discount adjustment cost is arrived at by comparing discounted capacity and revenues to recourse rates to determine the total amount of costs unrecovered in the discounted rate agreements, not by examining depreciated facility costs. Trial Staff examined El Paso's Compliance Filing rates to determine whether they are based on billing determinants that are reduced below the threshold level (less capacity reservation nominations or CRNs). Trial Staff maintains that for all three rate periods, El Paso's compliance recourse rates are based on billing determinants that are lower than the threshold level and thus result in higher rates for maximum rate Article 11.2(b) shippers than if the minimum threshold level is used. These analyses show that El Paso's 2011 rate proposal would improperly ask protected customers to bear costs in violation of Article 11.2(b) and that El Paso has not shown that it absorbed the portion of the discount adjustment included in the Article 11.2(b) rates. Therefore, the Commission finds that El Paso has failed to meet its burden of sufficiently demonstrating that Article 11.2(b) shippers would not be charged the costs of discounted or unsubscribed capacity as defined in the 1996 Settlement. Because service volumes have fallen below the 4,000 MMcf/d threshold for the time period covered by this proceeding, coupled with the fact that El Paso's requested discount adjustment would transfer costs to non-Article 11.2 maximum rate contracts, it is

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[607] Opinion No. 528 at P 490.

[608] *See* Rate Protected Shippers Brief Opposing Exceptions at 15. *See also* Trial Staff's argument at Brief Opposing Exceptions at 31-32 using a different approach to reach a similar conclusion.

[609] Opinion No. 528, 145 FERC ¶ 61,040 at P 530.

necessary to develop a remedy to ensure that the discount costs are not borne by shippers protected by Article 11.2(b).

B. The Remedy

381. Opinion No. 528 found that shippers that hold contracts protected by Article 11.2(b) should not pay costs of unsubscribed or discounted 1995 capacity (through the discount adjustment or otherwise) under the 1996 Settlement. The Commission assigned to hearing the issue of what portion of the recourse rates represents costs of 1995 capacity covered by Article 11.2(b) and indicated that the hearing should develop an appropriate rate for these contracts which excludes such costs.[610] The Commission stated its expectation that the Participants in the remanded proceeding would use El Paso's Compliance Filing as the basis from which to determine the costs in contracts protected under Article 11.2(b) for which El Paso has responsibility under the 1996 Settlement and establish the adjusted rates applicable to those contracts.[611] The Commission also directed that the remanded proceeding address El Paso's assumption of costs under Article 11.2(b) and determine rates for Article 11.2(b) contracts. The Commission emphasized that issues not be relitigated, including recourse rates for non-Article 11.2(b) rates, or whether El Paso has met the 4,000 MMcf/d presumption, or otherwise satisfied the Article 11.2(b) requirements.[612]

The Remand Decision

382. At hearing, the Presiding Judge reviewed proposed remedies from Trial Staff, El Paso, Rate Protected Shippers and SoCal Gas/San Diego. Trial Staff proposed a billing determinant-based approach while the other Participants proposed a revenue crediting approach.[613]

383. The revenue-crediting approaches proposed by El Paso, SoCal Gas/San Diego, and Rate Protected Shippers measure the difference in the revenues generated from the actual

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[610] *Id.* P 533.

[611] *Id.* P 535.

[612] *Id.* P 536.

[613] In the alternative, Trial Staff proposed a remedy (Trial Staff's alternate remedy) based on the shortfall amount in the event that the Commission determines that the imputed amount of billing determinants should be limited to the shortfall. However, this methodology was not adopted by the Presiding Judge.

discounted rate contracts as compared to the revenues that would have been generated had they been priced at the Article 11.2(a) rate. The revenue-crediting remedies each start by establishing the capacity shortfall, which is defined as the amount of additional capacity that, if sold at or above the Article 11.2(a) rate, would cause El Paso to be in compliance with Article 11.2(b). The Participants then determine the revenue deficiency related to the capacity shortfall. El Paso and SoCal Gas/San Diego calculate the revenue deficiency by filling the shortfall by sequencing El Paso's discounted contracts from highest to lowest rate until the 4,000 MMcf/d capacity threshold is met, while Rate Protected Shippers use a proportionate amount of all long-term and short-term discounted contracts to fill the shortfall.[614]

384. Trial Staff's billing-determinants approach imputes billing determinants to ensure that capacity costs are allocated consistent with the threshold. To do so, Trial Staff increases the billing determinants underlying El Paso's Compliance Filing recourse rates proportionately to all zones and rates, to the threshold level. Trial Staff then derives reservation rates for eligible Article 11.2(b) shippers by dividing the reservation costs of service by the adjusted billing determinants for each period. Trial Staff compares the revenues generated by these rates with the revenues from the Compliance Filing rates to calculate the revenue shortfall that El Paso is required to absorb to meet the Article 11.2(b) requirement.[615]

385. After hearing, the Presiding Judge found that Trial Staff's remedy appropriately and reasonably removes any improper shift in costs of unsubscribed or discounted capacity below the Article 11.2(a) rates to eligible Article 11.2(b) shippers and should be adopted in full. The Presiding Judge found that although a revenue-crediting approach can achieve the same result, Trial Staff's proposed remedy is more easily and fairly administered, neutral and precise and, ultimately, represents a just and reasonable approach to removing any improper cost shift to Article 11.2(b) shippers. Furthermore, the Presiding Judge stated that none of the other Participants has submitted persuasive evidence that would indicate that Trial Staff's remedy should not be implemented in the instant proceeding.[616]

386. The Presiding Judge identified a number of factors supporting Trial Staff's remedy. First, the Presiding Judge noted that dollar amounts calculated via Trial Staff's remedy match Trial Staff's cost shift determinations. In addition, the Presiding Judge

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[614] *Id.* PP 154-158.

[615] *Id.* PP 151-153.

[616] *Id.* PP 150, 159.

found that the calculations agree with the definition of Article 11.2(b) in a precise, accurate, and reasonable manner. In fact, the Presiding Judge stated that Trial Staff's remedy appropriately accounts for El Paso's overcharges and, in accordance with Article 11.2(b), ensures that El Paso bears the responsibility for the existing and future step-downs or terminations, discounted contracts, and the associated contract demand (CD)/billing determinants related to the capacity as described in Article 11.2(b).

387. Second, the Presiding Judge found that Trial Staff's remedy avoids the unnecessary arbitrariness found in the other proposals in this proceeding. Third, the Presiding Judge noted that the September 5 Order appears to prohibit the use of a capacity shortfall. Based on the fact that El Paso has not shown that it met the presumption threshold or otherwise satisfied the Article 11.2(b) requirement, the Presiding Judge found that no unsubscribed or discounted capacity may be included in the rates of eligible shippers under any of the proposed remedies. The Presiding Judge stated that the remedies of El Paso, Rate Protected Shippers, and SoCal Gas/San Diego, as well as the alternate remedy of Trial Staff, all use the capacity shortfall in their calculations. The Presiding Judge determined that any remedy adopted in the remand proceeding may not be reduced by unsubscribed or discounted capacity, as relying on the capacity shortfall to implement a remedy would eviscerate the protections afforded to shippers protected by Article 11.2(b). The Presiding Judge concluded that Trial Staff's remedy is the only remedy that does not improperly rely on the capacity shortfall. Furthermore, the Presiding Judge found that Trial Staff's primary remedy is the only approach that is fully in accordance with the Commission's Opinion No. 528 remand as it uses El Paso's Compliance Filing data as a basis for its testimony and exhibits and clearly demonstrates a cost shift to the Article 11.2(b) shippers' rates. The Presiding Judge states that none of the other methods has achieved this combined result.[617]

Briefs On Exception

El Paso

388. El Paso defends its methodology for computing a rate adjustment remedy. El Paso states pipeline proposals must be accepted if they are just and reasonable even if there are other rates or methodologies that are also just and reasonable.[618] According to El Paso,

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[617] Remand Decision, 148 FERC ¶ 63,014 at PP 151-175.

[618] El Paso Brief on Exceptions at 58 (citing *Columbia Gas Transmission LLC,* 131 FERC ¶ 61,193, at P 21 (2010); *Consolidated Edison*, 165 F.3d 992, 998, 1002-4 for the proposition that pipeline proposals found to be just and reasonable are given deference over other just and reasonable proposals even if the proposals arise under NGA section 5; *ANR Pipeline Co.*, 110 FERC ¶ 61,069, at P 49 (2005) (*ANR Pipeline*); *Kinder*

(continued...)

the Presiding Judge must first find that El Paso's proposal is unjust and unreasonable before accepting another, which the Presiding Judge failed to do. El Paso characterizes the Remand Decision as instead making findings that apply to the revenue deficiency methodology generally. El Paso objects to any finding that the existence of multiple methodologies for filling the capacity shortfall with discounted contracts makes its preferred methodology arbitrary.[619] El Paso argues that sequencing discounted contracts from highest to lowest rate is the most logical and reasonable method because it is consistent with the rationale of the 4,000 MMcf/d presumption that the highest priced contracts sold by El Paso are attributable to 1995 capacity.[620]

389. El Paso objects to Rate Protected Shippers' proposed methodology of using a proportionate amount of all discounted rate contracts regardless of rate for several reasons: (a) it is inconsistent with the rationale of the Commission's presumption that the highest rate contracts should be considered 1995 capacity and would require El Paso to absorb costs because it expanded its capacity after 1995 at its customers' request, which created a need to provide deep discounts during the test period; (b) it assumes that every discounted contract on the system includes a discount of 1995 capacity; (c) including deeply discounted contracts in the computation of the revenue deficiency would provide a disincentive for El Paso to enter into such contracts; (d) inclusion of short-term contracts ignores the sculpted contracts that leave El Paso with less marketable off-peak capacity that El Paso must sell at deeply discounted rates; and (e) it is inconsistent with regard to treatment of interruptible transportation service. El Paso argues that Rate Protected Shippers' remedy should be rejected.[621]

390. El Paso argues that the Presiding Judge erred in concluding that the use of a capacity shortfall in any remedy would improperly reduce the remedy by unsubscribed or discounted capacity. El Paso states that the use of the capacity shortfall to establish the level of 1995 capacity that may be deemed to be unsubscribed or discounted does not

Morgan Interstate Gas Transmission, L.L.C., 134 FERC ¶ 61,061, at P 30 (2011) (*Kinder Morgan*)).

[619] El Paso Brief on Exceptions at 60 (referencing Rate Protected Shippers, El Paso and SoCal Gas/San Diego methodologies).

[620] *Id.* at 60-62.

[621] *Id.* at 62-65.

reduce the remedy, but simply establishes an assumed level of 1995 capacity from which the revenue deficiency can be measured.[622]

391. El Paso objects to the Presiding Judge's adoption of Trial Staff's remedy, contending that the billing determinant methodology does not measure a shift in unsubscribed or discounted 1995 capacity because it does not examine 1995 costs at all. Moreover, El Paso raises three additional objections to Trial Staff's proposed Article 11.2(b) rate calculation: (a) Trial Staff erroneously utilizes El Paso's maximum recourse rates, as opposed to the Article 11.2(a) rates, to determine what rates are discounted for purposes of calculating discount-adjusted billing determinants; (b) Trial Staff fails to appropriately treat short-term firm billing determinants and revenues in its analysis; and (c) Trial Staff fails to appropriately treat interruptible services and revenues.[623]

392. El Paso argues that Trial Staff's remedy uses the wrong rate in calculating discount-adjusted billing determinants. El Paso cites the testimony of its witness Ms. Rezendes, which criticized imputing billing determinants at the maximum recourse rate instead of the Article 11.2(a) rate as overstating the cost shift and consequently Trial Staff's proposed rate adjustment. El Paso states that Trial Staff's proposed remedy must be corrected to use the lower Article 11.2(a) rate as the maximum to impute billing determinants, if it is not rejected.[624]

393. El Paso claims that Trial Staff's calculation of imputed billing determinants is flawed because it fails to properly account for the fact that short-term firm revenues were credited to the cost of service in El Paso's compliance rates. As a result, El Paso claims that it is improperly being put in a position where it is at risk to sell all of its capacity on a long-term firm basis to make itself whole, while utilizing a cost of service that incorporates a revenue credit for additional short-term firm sales of capacity. However, El Paso explains that it cannot sell short-term firm service using capacity that has already been sold on a firm basis.[625]

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[622] *Id.* at 65.

[623] *Id.* El Paso states the flaws discussed in the section apply to both of Trial Staff's proposed remedies.

[624] El Paso Brief on Exceptions at 66-69.

[625] *Id.* at 69-74.

394. El Paso states that in Opinion No. 517, the Commission found that certain types of contracts, such as short-haul, backhaul and east flow contracts, should count toward the presumption because they "provide revenues that contribute to El Paso's cost of service."[626] El Paso argues that it therefore follows that any contracts that cover the costs of 1995 capacity, including revenues from interruptible contracts, should be reflected in the determination of an Article 11.2(b) rate adjustment. El Paso states if the Remand Decision's finding of an impermissible cost shift is not reversed for this reason, and Trial Staff's billing determinants methodology is nonetheless accepted, the Article 11.2(b) rates derived must be revised to correct for this error.[627]

395. El Paso argues that the Presiding Judge erred by striking evidence of equitable factors from El Paso's testimony. El Paso contends that if the Commission finds that Article 11.2(b) has not been satisfied, only a nominal remedy should be imposed due to equitable factors. El Paso states its witness Ms. Rezendes explained that, to the extent it is found that El Paso's revenues do not exceed the cost of 1995 capacity, such a revenue deficiency would be caused, at least in significant part, by the Article 11.2(b) shippers themselves. El Paso states that, by first demanding that El Paso construct additional capacity, and then subsequently relinquishing El Paso's capacity, the Article 11.2(b) shippers' actions resulted in excess capacity and a need for El Paso to provide substantial discounts to sell its services. El Paso states the intent of Article 11.2(b) was to protect such shippers from costs of turnback capacity by other shippers, not their own capacity turnbacks. El Paso argues that the doctrine of collateral estoppel prohibits a party from bringing a claim on an issue that has already been decided, but does not prohibit a party from advancing facts raised in a prior proceeding in regards to a different issue, as is the case here. El Paso asserts that whether the equitable factors recited in Ms. Rezendes' testimony should impact any remedy required by Article 11.2(b) has never been addressed and was appropriately raised in testimony. El Paso asserts that because the purpose of the hearing is to determine a rate that complies with Article 11.2(b), it is relevant and important to know what rate protections were intended by the settlement provision.[628]

Rate Protected Shippers

396. Rate Protected Shippers argue the Presiding Judge erred by failing to adopt their remedy method, as the only proposal that is consistent with Opinion Nos. 517 and 528

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[626] *Id.* at 74 (citing Opinion No. 517, 139 FERC ¶ 61,095 at P 327).

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

[628] *Id.* at 75-77.

and easily implemented in future El Paso rate proceedings. Rate Protected Shippers tout their revenue credit method as being unaffected by the manner in which El Paso designs its rates. Under their methodology, Rate Protected Shippers propose to measure the shortfall which demonstrates that El Paso is not covering its capacity sales obligations under Article 11.2(b). The shortfall is to be calculated by subtracting the contracts that count toward the threshold from the 4,000 MMcf/d (4,068 Dth/d equivalent) threshold. Rate Protected Shippers explain that, once the shortfall has been identified using the criteria clarified in Opinion No. 517, the revenue credit method can be applied simply by evaluating El Paso's discounted contract quantities proportionately. Rate Protected Shippers argue that, in contrast, Trial Staff's billing determinant method relies upon the specific compliance rates as well as other data generated by El Paso in the Compliance Filing. Rate Protected Shippers claim this method can in some circumstances result in the development of Article 11.2(b) rates that are not in compliance with Article 11.2(b) and the Commission's rulings in Opinion Nos. 517 and 528.[629]

397. Rate Protected Shippers argue that the Presiding Judge failed to determine the correct shortfall quantity as the starting point for calculating a remedy. Rate Protected Shippers contend that their witness Mr. Lander was the only witness to offer a Primary and Alternate Case based on whether the capacity shortfall was 614,139 Dth/d as stated by the Commission in Opinion No. 528 or 579,805 Dth/d as stated in El Paso's Compliance Filing. Rate Protected Shippers object to the Presiding Judge's determination that the Rate Protected Shippers method is subjective and arbitrary because it offered the two alternatives.[630]

398. Rate Protected Shippers contend that the Presiding Judge's rationale for rejecting their remedy is not reasoned decision-making. Rate Protected Shippers explain that each remedy attempts to calculate the costs that must be eliminated from the Article 11.2(b) shippers' rates and the additional revenues needed to meet the 4,000 MMcf/d threshold presumption. Each remedy fills the capacity shortfall by selecting the discounted contracts (and the associated discount value of those discounted contracts) to value the shortfall. Rate Protected Shippers state that the sum of those discounted contracts is the Article 11.2(b) revenue credit that is applied to the final cost of service to develop rates applicable to Article 11.2(b) Shippers.[631]

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[629] Rate Protected Shippers Brief on Exceptions at 7-9.

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

[631] *Id.* at 10-11.

399. Rate Protected Shippers argue that the method of valuing the capacity associated with the shortfall is critical to the rate calculation and should be objective and transparent. Rate Protected Shippers assert that only its method and Trial Staff's methods meet those criteria. Rate Protected Shippers claim that El Paso's method is neither objective nor transparent and is driven by arbitrary and self-serving assumptions. Rate Protected Shippers cite Trial Staff's explanation that Trial Staff and Rate Protected Shippers "apply a proportionate approach because [El Paso's] system is integrated. [El Paso's] whole case in this proceeding is premised on its efforts to identify and separate costs of 1995 and post-1995 capacity. The Commission already has rejected vintage costs of service for [El Paso]. The proportionate approach is the only viable way to remedy the capacity shortfall because it is not possible to determine which contracts use which facilities or which costs (other than plant costs) are associated with which facilities."[632]

400. Rate Protected Shippers argue that the Remand Decision is devoid of any explanation why their method is not precise, neutral, and easily and fairly administered, which are the virtues the Presiding Judge attributed only to the Trial Staff's primary method. Rate Protected Shippers counter that Trial Staff's primary remedy method is readily subject to manipulation by El Paso, and if manipulated, the resulting rates will be inconsistent with the requirements of Article 11.2(b) as interpreted by the Commission. Rate Protected Shippers further state the Presiding Judge failed to consider that Trial Staff included prohibited maximum rate equivalents of discounted contracts in its remedy calculations.[633]

401. Rate Protected Shippers argue that the Presiding Judge incorrectly rejected all the revenue credit methodologies, including both Rate Protected Shippers' method and Trial Staff's alternate method, based on the mistaken assumption that a revenue credit remedy is somehow adding the costs of unsubscribed or discounted capacity to the Article 11.2(b) rates contrary to Article 11.2(b). Rate Protected Shippers contend that a revenue credit remedy does not add anything to Article 11.2(b) rates but instead reduces the cost of service for the Article 11.2(b) rates, thus reducing the otherwise applicable maximum recourse rates to levels compliant with Article 11.2(b). Rate Protected Shippers object to the Presiding Judge's finding that only Trial Staff illustrated a cost shift. Rate Protected

[632] Rate Protected Shippers Brief on Exception at 11-12 (citing Trial Staff Reply Br. 22 (footnote omitted)).

[633] Rate Protected Shippers Brief on Exceptions at 13-14. Maximum rate equivalents are a measurement of discounted contracts comparing them to the service volume that the revenues of the discounted contracts would otherwise support at recourse rates.

Shippers explain that, although they presented a full set of illustrative rates, they did not request a finding of fact on the remedy because calculating final rates is futile before the Commission reviews the rates and methodologies in the Compliance Filing.[634]

402. Rate Protected Shippers state that their remedy is the most versatile going forward, for it provides a long-term solution in the form of an algorithm, which was translated into a tariff provision. Rate Protected Shippers argue that the remedy method must provide a reasonable mechanism for establishing Article 11.2(b) rates and thus it is important for the Commission to understand the evidence of the impacts associated with various remedy proposals. Rate Protected Shippers state the cost impact of the various remedies is confusing because (a) Trial Staff calculated the dollars that El Paso would not collect under its remedy while Rate Protected Shippers calculated a total system cost of service credit which is greater than the actual cost impact on El Paso, (b) the actual cost impacts on El Paso will decrease at least by half because of contract changes since the rate case was filed, and (c) the cost impact presented by Trial Staff does not show the cost impact of removing maximum rate equivalents from the billing determinants.[635] Rate Protected Shippers assert that if maximum rate equivalents are removed from Trial Staff's remedy, the Rate Protected Shippers' remedy would produce similar results to Trial Staff's in this case but Trial Staff's method cannot be applied in future rate filings without correction for El Paso's specific discount adjustment methods. Rate Protected Shippers argue that their method can be employed whether or not El Paso changes the method it uses to perform discount adjustments in future rate cases and is entirely consistent with Commission precedent and with how El Paso has designed rates historically.

403. Rate Protected Shippers object to a Trial Staff assumption that the difference between the threshold and the El Paso-derived billing determinants shown in the Compliance Filing represents the total amount of the discounted and unsubscribed 1995 capacity costs that El Paso may not collect from Article 11.2(b) Shippers. According to Rate Protected Shippers, these billing determinants include values for El Paso's sales of discounted capacity. They object to such an assumption because the data includes prohibited maximum rate equivalents for El Paso's sales of long-term firm capacity at a discounted rate. Rate Protected Shippers contend that, if the Commission affirms the Presiding Judge's selection of Trial Staff's primary remedy, billing determinants for maximum rate equivalents should be excluded for the Article 11.2(b) remedy. Rate

[634] Rate Protected Shippers Brief on Exceptions at 15-18.

[635] Rate Protected Shippers Brief on Exceptions at 19-22 (explaining that, after settlements with certain shippers, Article 11.2(b) contracts represent 8.5 percent of firm capacity sold, down from 17 percent at the start of the rate case; citing Ex. RPS-1R at 6, 12).

Protected Shippers state that the consequence of failing to remove maximum rate equivalents is an inflated denominator in the remedy calculation.[636]

404. Rate Protected Shippers propose that Trial Staff's remedy be corrected by adjusting two inputs from the Compliance Filing to reflect only long-term contracts priced at or above the Article 11.2(a) rate thereby eliminating the prohibited maximum rate equivalents associated with long-term firm discounted contracts priced below the Article 11.2(a) rate.[637] If the Commission fails to adopt their remedy, Rate Protected Shippers alternatively request the Commission to direct El Paso to make the necessary correction to its Compliance Filing rates before Article 11.2(b) rates are implemented.[638]

Trial Staff

405. Trial Staff supports the Presiding Judge's selection of its remedy as being fairly administered, neutral, and precise. Trial Staff argues, however, that the Presiding Judge misapplies the September 5 Order and, as a result, mistakenly rejects Trial Staff's alternate remedy.[639] Trial Staff argues that the September 5 Order does not prohibit the "use" of the capacity shortfall in crafting an Article 11.2(b) remedy. Trial Staff describes the shortfall as a capacity amount associated with El Paso's failure to meet the presumption. Trial Staff argues that the September 5 Order is silent on how to craft a remedy and that it is appropriate to develop a remedy using the capacity shortfall amount and excluding prohibited costs from Article 11.2(b) shippers' rates either by imputing billing determinants or applying a revenue credit to "fill" or eliminate the capacity

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[636] Rate Protected Shippers Brief on Exceptions at 26-28.

[637] Rate Protected Shippers Brief on Exceptions at 31-32 (stating that first, the values in Ex. S-2R, column (i) (reservation billing determinants) should be replaced with those from solely maximum rate contracts and other long-term firm contracts priced at or above the Article 11.2(a) rate, thereby eliminating the prohibited maximum rate equivalents associated with long-term firm discounted contracts priced below Article 11.2(a) rates. Second, make a corresponding adjustment to column (e) (total reservation allocated costs) so the revenues are not overstated by including revenues from prohibited maximum rate equivalents).

[638] Rate Protected Shippers Brief on Exceptions at 31-32.

[639] Trial Staff Brief on Exceptions at 8 (citing *Remand Decision*, 148 FERC ¶ 63,014 at P 167; September 5 Order, 124 FERC ¶ 61,227 at P 98).

shortfall. Trial Staff defends its alternate remedy as an appropriate remedy, which uses imputed billing determinants to eliminate the capacity shortfall. Trial Staff argues that, by imputing billing determinants in the amount of the capacity shortfall, its alternate remedy excludes the costs of unsubscribed and discount capacity that the Commission stated could not be included in Article 11.2(b) rates. Trial Staff states that its alternate remedy does not "reduce" the remedy by unsubscribed or discounted capacity, nor does it "eviscerate the protections" provided by Article 11.2(b), but instead lowers the rates, which increases the overall remedy amount and preserves the Article 11.2(b) protections. Trial Staff requests that the Commission reverse the Presiding Judge's determination that Trial Staff's alternate remedy improperly relies upon the capacity shortfall amount.[640]

<u>Briefs Opposing Exceptions</u>

Trial Staff

406. Trial Staff states that although it did not use a revenue credit approach, it created a table showing an apples-to-apples comparison of the cost-of-service credits used to design remedy rates for each period under the various remedy proposals. Because its primary remedy is not based on a cost-of-service revenue credit, Trial Staff used values calculated by El Paso witness Ms. Rezendes. Trial Staff states that because El Paso will only charge remedy rates to Article 11.2(b) shippers, the dollars El Paso would be required to absorb would be far less than the value of the credits shown in the table. Trial Staff includes the following Table to illustrate the balanced, conservative nature of its primary remedy and support the Presiding Judge's finding that its remedy is just and reasonable.[641]

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[640] Trial Staff Brief on Exceptions at 9-13.

[641] Trial Staff Brief Opposing Exceptions at 35-39.

TABLE
Effective Cost of Service Credit (Millions of Dollars)

Party	**Period 1**	**Period 2**	**Period 3**
El Paso[642]	$10.1	$10.1	$10.1
SCG/SDG&E[643]	10.1	10.1	10.1
Trial Staff (primary)[644]	17.0	17.0	23.0
RPS (primary)[645]	37.6	37.6	37.6
RPS (alternate)[646]	35.5	35.5	35.5

407. Trial Staff supports the Presiding Judge's defense of Trial Staff's remedy and rejection of El Paso's claim that any remedy calculations should include an offset for revenues from interruptible contracts. Trial Staff acknowledges that interruptible revenues should be included but states that its remedy already appropriately reflects those revenues because it incorporates El Paso's Compliance Filing which includes a cost-of-service revenue credit for these revenues that reduces the cost of service for El Paso's facilities, including the 1995 facilities, and thus benefits all shippers that pay El Paso's Compliance Filing recourse rates. Trial Staff argues that El Paso is asking the Commission to deny Article 11.2(b) shippers the benefit of a credit that is embedded in El Paso's recourse rates and that benefits all other shippers.[647]

408. Trial Staff argues that the Presiding Judge properly rejected El Paso's assertion that Trial Staff's remedy improperly imputes billing determinants because it measures discounts by reference to El Paso's maximum rates rather than Article 11.2(a) rates. Trial

[642] Ex. EPG-16R at 48-49; Ex. EPG-31R; Ex. EPG-32R. Ms. Rezendes adopted Mr. Crisp's calculation of a revenue credit. Ex. EPG-16R at 48; Ex. TGS-2R.

[643] Ex. SCG-2R.

[644] Ex. EPG-37R at 15.

[645] Ex. RPS-9R at 1, 15.

[646] Ex. RPS-10R at 1, 15.

[647] Trial Staff Brief Opposing Exceptions at 40-41.

Staff states that El Paso misunderstands Trials Staff's remedy. First, Trial Staff states that its remedy does not impute billing determinants "at" any specific rate but rather imputes the *volume* of billing determinants required to design rates based upon the threshold level of billing determinants less the CRNs. Trial Staff contends that its remedy yields Article 11.2(b) rates that would have resulted if El Paso had met the threshold, without requiring the review of rates associated with discounted contracts or the imputation of billing determinants "at" any rate. Trial Staff defends its remedy against El Paso's contention that it does not accurately measure the cost shift, stating that it measures the cost shift as the difference between the revenues El Paso would receive from Article 11.2(b) rate-protected shippers if they were charged El Paso's recourse rates and the revenues El Paso would receive from such shippers if they were charged the Article 11.2(b) rates Trial Staff has calculated.[648]

409. Trial Staff argues that its primary remedy properly accounts for short-term firm volumes. Trial Staff contends that El Paso's request to add $20 million in short-term firm revenues to the Compliance Filing's cost-of-service underlying Trial Staff's remedy is invalid and against basic rate-design principles. Trial Staff states that in the proper design of recourse rates, in order to reflect sales of a specific type of capacity, either a revenue credit or discount-adjusted billing determinants should be applied. Trial Staff states that if both methodologies were applied, the resulting rates artificially would be deflated due to the lower cost of service and the higher number of billing determinants. Trial Staff further states that if neither methodology were applied, shippers' rates would be artificially inflated because the resulting rates would not reflect the revenues at all and the pipeline alone would benefit from the revenues. Trial Staff states that its remedy utilizes the revenue crediting principle by using the Compliance Filing as the starting point, which incorporates a short-term firm revenue credit. Trial Staff further states that, consistent with El Paso's position that deeply discounted short-term firm contracts should not be used to fill the shortfall, El Paso's short-term firm contract billing determinants are not reflected in Trial Staff's remedy calculations.[649] Trial Staff concludes that the

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[648] *Id.* at 41-45 (citing Ex. S-1R at 7; Ex. S-2R at 2, 4, 7).

[649] *Id.* at 47-48 n.38:

> This is because the volumes imputed to reach the threshold under the primary remedy are still within the long-term firm discounted contract level. Under the primary remedy, the imputed billing determinants are 199,124 Dth/day in Period 1; 197,799 Dth/day in Period 2; and 284,780 Dth/day in Period 3. Ex. S-2R at 1, 3, and 5. The volume of imputed billing determinants equals the total presumed saleable 1995 capacity

(continued...)

Commission should reject El Paso's request to revise Trial Staff's remedy related to El Paso's short-term firm sales.

410. Trial Staff argues that El Paso's remedy is unsupported and was properly rejected. Trial Staff argues that El Paso is wrong in arguing that the Presiding Judge must first find that El Paso's proposal was unjust and unreasonable before accepting another remedy. Trial Staff contends that El Paso's proposal was not akin to tariff and rate filings that meet the requirements of the NGA. Trial Staff argues that the Presiding Judge was correct to reject El Paso's remedy as unjust and unreasonable and identifies flaws in El Paso's remedy, including the fact that El Paso filled the shortfall by sequencing discounted contracts from highest to lowest rate and offset any remedy calculation with interruptible revenues. According to Trial Staff, these flaws diminish the remedy without basis. Trial Staff contends that El Paso has not, and cannot, demonstrate a link between the highest-rate contracts below the Article 11.2(a) rate and the 1995 capacity shortfall or, conversely, a link between the lowest-rate contracts and post-1995 capacity. Trial Staff notes that El Paso has admitted that its customers do not purchase access to 1995 or post-1995 capacity and that its services are supported by both 1995 and post-1995 capacity. Trial Staff thus argues that the shortfall must be filled with a portion of the

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> less the total reservation billing determinants reflected in El Paso's compliance filing. [Citing Tr. 344, 345–346 (Radel) as confirming the volume of imputed billing determinants in Period 1]. The long-term firm discounted billing determinants associated with contracts at less than the Article 11.2(a) rate already included in [El Paso's] compliance filing—and thus included in Trial Staff's starting point—are 408,571 Dth/day for Period 1; 409,497 Dth/day for Period 2; and 324,580 Dth/day for Period 3. [Ex. S-19R].
>
> Based on the above values, the billing determinants associated with contracts discounted at less than the Article 11.2(a) rate that are reflected in Trial Staff's primary remedy rate design are 607,695 Dth/day in Period 1; 607,296 Dth/day in Period 2; and 609,360 Dth/day in Period 3. However, the total long-term firm discounts below the Article 11.2(a) rate for Periods 1, 2 and 3 are 809,515 Dth/day. [Ex. EPG-10R]. This quantity appreciably exceeds, in each period, the billing determinants associated with contracts discounted below the Article 11.2(a) rate that are reflected in Trial Staff's primary remedy rate design.

discounted contracts across the system, and El Paso's preferred sequencing of contracts should be rejected.[650]

411. Trial Staff asks the Commission to reject Rate Protected Shippers' requested adjustment to its remedy. Trial Staff argues that it correctly used the Compliance Filing rates as a starting point for the remedy, as required by Opinion No. 528. Trial Staff does not dispute that any remedy-related calculation is illustrative and subject to adjustments for changing Article 11.2(b) contract levels and for Commission action on the pending Compliance Filing and requests for rehearing, but argues that its illustrative rate calculations helped to ensure a complete record. Trial Staff argues that, contrary to Rate Protected Shippers' claim that Trial Staff's remedy is the "outlier methodology," Trial Staff's table shows that its remedy avoids the more extreme results yielded by the other remedies proposed.[651]

412. Trial Staff argues that its primary remedy appropriately treats maximum rate equivalents that are included in the Compliance Filing and that the adjustment proposed by Rate Protected Shippers for the first time in its Brief on Exceptions is not required. Trial Staff argues that the requested adjustment amounts to a request that Trial Staff alter the rate design that El Paso uses to account for these contracts by applying a revenue credit rather than discount-adjusted billing determinants. Trial Staff contends that such an adjustment is unwarranted, just as an adjustment to change El Paso's rate design to treat interruptible revenues would be. Trial Staff further argues that Rate Protected Shippers mistakenly assert that Trial Staff's remedy assumes that the difference between the threshold and the Compliance Filing billing determinants represents the total amount of the discounted and unsubscribed 1995 capacity costs that El Paso may not collect from Article 11.2(b) shippers. To the contrary, Trial Staff states that the measure of the impermissibly shifted costs is not equal to the level of imputed billing determinants but, rather, is the difference between the revenues El Paso would receive from Article 11.2(b) shippers if they were charged El Paso's recourse rates and the revenues El Paso would receive from such shippers if they were charged the Article 11.2(b) rates calculated by Trial Staff witness Ms. Radel.[652]

413. Trial Staff argues that the Presiding Judge properly struck El Paso's direct testimony and evidence regarding its cost and revenue study and certain equitable factors.

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[650] Trial Staff Brief Opposing Exceptions at 50-56 (citing Ex. EPG-1R at 34; Ex. EPG-16R at 28; Ex. RPS-30R; Tr. 81, 130, 131 (Rezendes)).

[651] *Id.* at 57-60.

[652] *Id.* at 60-64.

Trial Staff argues that El Paso's exceptions regarding stricken testimony should be rejected, for the Presiding Judge's grounds for striking the testimony are consistent with the principle that "[m]otions to strike may also be granted where the evidence in question constitutes a collateral attack on a Commission order or violates the doctrine of res judicata."[653] Trial Staff argues that the Presiding Judge properly found that El Paso's cost and revenue study in its direct testimony violates Opinion No. 528 because (a) it presented a bifurcated cost and revenue analysis contrary to the Commission's rejection of a bifurcated cost of service and (b) it collaterally attacked the Commission's prior finding that El Paso had not otherwise satisfied Article 11.2(b). Trial Staff states that the Commission directed El Paso to use a single cost of service in its Compliance Filing instead of a bifurcated cost of service and to use that Compliance Filing as the basis for its calculations in the remand proceeding. Trial Staff further contends that El Paso's equitable factors evidence constitutes impermissible relitigation of issues already rejected by the Commission and outside the scope of this proceeding.[654]

El Paso

414. El Paso contends the Rate Protected Shippers' proposed remedy is not just and reasonable and is no more versatile, objective or easy to implement than its proposed remedy. El Paso disagrees with Rate Protected Shippers' contention that "El Paso essentially argued that no remedy was required" and that "El Paso's whole case in this proceeding is premised on its efforts to identify and separate costs of 1995 and post-1995 capacity."[655] El Paso counters by stating its proposed remedy was not based on the identification of the cost of its 1995 system, but it is necessary to identify 1995 costs in El Paso's current rates in order to determine whether there is an impermissible cost shift in those rates, and El Paso is the only participant in the case to identify such costs.[656]

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[653] *Id.* at 64 (citing *February 26 Order*, Docket No. RP10-1398-003 at P 16; *NSTAR Elec. Co. v. ISO New England*, 120 FERC ¶ 61,261 at P 33 (2007)).

[654] Trial Staff Brief Opposing Exceptions at 67-69 (citing *February 26 Order* at P 18; Opinion No. 517, 139 FERC ¶ 61,095 at P 244; Opinion No. 528, 145 FERC ¶ 61,040 at P 450). Trial Staff states that the stricken testimony purportedly supports El Paso's argument that it was forced to provide substantial discounts due to demands by its customers, including Article 11.2(b) shippers, to expand its capacity and their subsequent turn-backs of capacity.

[655] Rate Protected Shippers Brief at 2-3 and 11-12 (citing Trial Staff's Reply Brief at 22).

[656] El Paso Brief Opposing Exceptions at 3-4.

415. El Paso disagrees with Rate Protected Shippers' contention that the choice of remedy is only between Trial Staff's primary remedy and Rate Protected Shippers' remedy. El Paso argues that, if the Commission determines that the record demonstrates by a preponderance of the evidence that an impermissible cost shift has occurred, Commission and court precedent require that El Paso's methodology be accepted if it is found just and reasonable regardless of the other methodologies proposed in the case.[657]

416. Regarding Rate Protected Shippers' claim that its proposed remedy properly assumes all discounted contracts contribute to El Paso's failure to meet the threshold in equal proportion due to the integrated nature of El Paso's system, El Paso argues that this contention is fundamentally at odds with Article 11.2(b) and the rationale of the Commission's presumption and is unreasonable for a number of reasons discussed in El Paso's Brief on Exceptions. El Paso states that the Commission determined that the most reasonable assumption is that all maximum rate contracts should be deemed to use 1995 capacity before any such contracts are attributed to post-1995 capacity.[658] El Paso asserts Rate Protected Shippers' argument is also contrary to the central rationale underlying the presumption because it would cause El Paso to absorb costs due to its construction of post-1995 expansions, contrary to the intent of Article 11.2(b). In addition, El Paso argues that its remedy is the only reasonable presumption-based remedy for the future because it does not provide a disincentive to El Paso to sell short-term firm service.[659]

417. El Paso disagrees with Rate Protected Shippers' position that the capacity shortfall is 614,139 Dth/d, as opposed to the 579,805 Dth/d calculated by every other party. El Paso states that the Commission required the Participants to use the data in El Paso's Compliance Filing and that the 579,805 Dth/d shortfall calculation reflects the billing determinants that were approved in Opinion No. 528 and used in the Compliance Filing.[660]

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[657] *Id.* at 5-6 (citing El Paso Brief on Exceptions at 58; *Columbia Gas Transmission LLC,* 131 FERC ¶ 61,193, at P 21 (2010); *Consolidated Edison,* 165 F.3d 992, 998, 1002-4; *ANR Pipeline,* 110 FERC ¶ 61,069 at P 49; *Kinder Morgan*, 134 FERC ¶ 61,061 at P 30).

[658] El Paso Brief Opposing Exceptions at 6-7 (citing *September 5 Order*, 124 FERC ¶ 61,227 at P 98).

[659] *Id.* at 7.

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

418. El Paso agrees with Rate Protected Shippers that Trial Staff's remedy does not accurately measure an impermissible cost shift, but disagrees with Rate Protected Shippers' argument that Trial Staff's methodology is flawed because its use of maximum rate equivalents as a starting point to impute billing determinants conflicts with the Commission's decision not to count maximum rate equivalents toward the threshold presumption. El Paso states that the Commission refused to count maximum rate equivalents toward the presumption because they do not represent capacity sold at the Article 11.2(a) maximum rate for Article 11.2(b) purposes.[661]

419. El Paso argues that Rate Protected Shippers conflate the purpose of the threshold presumption, which is intended to determine whether there is any unsubscribed or discounted 1995 capacity, with a remedy's objective of eliminating an impermissible cost shift. El Paso argues that these are two separate analyses with different objectives. El Paso contends that failure to meet the threshold presumption says nothing about whether the discount involved 1995 costs or whether there has been a shift of such costs to the Article 11.2(b) shippers. El Paso states while the Commission declined to count maximum rate equivalents toward the presumption threshold because they are not maximum rate contracts, it acknowledged that the revenues from these contracts are a source of revenue for El Paso. El Paso argues as a revenue source, maximum rate equivalents and their associated revenue contribute toward 1995 costs and must be considered in determining whether there is an impermissible cost shift (assuming the presumption was not satisfied), and if so, how to design a remedy to eliminate such a cost shift.[662]

420. El Paso states Rate Protected Shippers' purported correction of Trial Staff's primary remedy fails to correct Trial Staff's remedy and is otherwise flawed. El Paso claims changing the starting level by eliminating maximum rate equivalents will not change Trial Staff's proposed Article 11.2(b) rates and that this fact alone demonstrates that Trial Staff's methodology does not measure an impermissible cost shift. El Paso argues Rate Protected Shippers' proposed "correction" to Trial Staff's flawed methodology is simply to disallow some unspecified level of costs from El Paso's rates without any showing that they represent a shift in the cost of discounted 1995 capacity.[663]

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[661] El Paso Brief Opposing Exceptions at 9-11 (citing Opinion No. 517, 139 FERC ¶ 61,095 at P 329; Rate Protected Shippers Brief on Exceptions at 24).

[662] *Id.* at 10-13.

[663] *Id.* at 13-14.

421. El Paso states Trial Staff's alternate remedy suffers from the same flaws as its primary remedy and should be rejected for the same reasons. El Paso states that the fact that Trial Staff has proposed two different imputed billing determinants levels under both of its remedy methodologies illustrates "the lack of any theoretical nexus between its proposed remedies and its asserted elimination of an impermissible cost shift."[664] El Paso argues that because Trial Staff's two proposals produce two different imputed billing determinants levels and two different sets of Article 11.2(b) rates, they both cannot measure an impermissible cost shift.

422. El Paso further argues that, like Trial Staff's primary remedy, Trial Staff's alternate remedy (a) inappropriately uses El Paso's maximum recourse rates to calculate discount-adjusted billing determinants instead of the Article 11.2(a) rate, which is the maximum rate for Article 11.2(b) purposes, and (b) fails to reflect the contribution to 1995 costs provided by revenues derived from both interruptible and short-term firm services. El Paso argues that, because Trial Staff's remedies are based on El Paso's Compliance Filing, which includes a $20 million credit to the cost of service for short-term firm service revenues, that revenue credit must first be converted into an equivalent billing determinants level in the design of the rates. El Paso argues that the $20 million in costs that were removed from the cost of service by the short-term firm services credit must be added back to the cost of service to properly account for short-term firm service.[665]

Rate Protected Shippers

423. Rate Protected Shippers defend the Presiding Judge's findings. Rate Protected Shippers state it is undisputed that El Paso's post-1995 capacity equals only 550 MMcf/d (559,350 Dth/d), and the amount of El Paso's total (long-term firm and short-term firm) discount-adjusted capacity priced below Article 11.2(a) rates equals 1,564,972 Dth/d. They argue that El Paso's proposed modification to Trial Staff's primary remedy to add maximum rate equivalent billing determinants as representing short-term firm capacity discounted below Article 11.2(a) rates, therefore, is nonsensical because it is impossible that the 1,564,972 Dth/d of discounted contract capacity flows on the 559,350 Dth/d of post-1995 capacity. Rate Protected Shippers disagree with El Paso's exceptions challenging the Presiding Judge's reliance on the Trial Staff and Rate Protected Shippers testimony demonstrating El Paso's compliance rates improperly shift prohibited costs to Article 11.2(b) shippers. Rate Protected Shippers share El Paso's concerns, however, as to whether Trial Staff's primary remedy will correctly eliminate all such prohibited costs.

[664] *Id.* at 16.

[665] *Id.* at 16-18.

Rate Protected Shippers thus reiterate that its remedy is superior to Trial Staff's primary remedy, and offer a "patch" to Trial Staff's primary remedy if the Commission chooses not to adopt Rate Protected Shippers' remedy.[666]

424. Rate Protected Shippers argue that El Paso's numerous exceptions regarding Trial Staff's remedy demonstrate the implementation problems created if the approved remedy is not transparent and can be manipulated. Rate Protected Shippers argue that El Paso's exceptions would only invite controversy and litigation because it would encourage El Paso to manipulate its rate filing billing determinants to divorce the remedy calculation from the prohibited cost-shift finding. Rate Protected Shippers argue that its proportionate revenue credit method is superior; the four numeric inputs needed to calculate its revenue credit are set forth in individual contracts, are easily identifiable, and are thus not subject to manipulation by El Paso.[667]

425. Rate Protected Shippers state that El Paso challenges the Rate Protected Shippers' proportionate credit remedy method, even though it was not adopted. Rate Protected Shippers respond that, contrary to El Paso's exceptions, Rate Protected Shippers' remedy (a) is entirely consistent with the threshold presumption which treats all firm contracts priced at or above the Article 11.2(a) rate the same for determining whether El Paso has met the threshold; (b) appropriately includes short-term firm contracts, unlike El Paso's remedy, because discounted short-term firm contracts contribute to the shift of prohibited costs; (c) continues to recognize that short-term firm contracts affect whether El Paso has met the threshold, despite the fact that an earlier remedy did not count short-term firm capacity equally with long-term firm capacity; (d) is reasonable as demonstrated by its revenue credit amounts being in the middle of the pack compared to El Paso's; and (e) appropriately treats the interruptible revenue credit amounts.[668]

426. Rate Protected Shippers state El Paso's Article 11.2(b) rebuttal rates would not be entitled to any NGA section 4 presumption. Rate Protected Shippers argue El Paso's claim has no merit because El Paso failed to include Article 11.2(b) rates in the Compliance Filing and instead first presented the rates in rebuttal testimony. Moreover,

[666] Rate Protected Shippers Brief Opposing Exceptions at 33-35.

[667] *Id.* at 36-38. Rate Protected Shippers list the four inputs as (1) the quantity of MDQs sold at or above Article 11.2(a) rates, (2) the quantity of MDQs sold below Article 11.2(a) rates, (3) the rates at which El Paso sold the MDQs sold below Article 11.2(a) rates and (4) the number of CRNs associated with hourly services sold at or above Article 11.2(a) rates.

[668] *Id.* at 41-46.

Rate Protected Shippers state the question at hand is how best to enforce the terms of a settlement, and the Commission has wide discretion to select the best method to ensure compliance with the terms of Article 11.2.[669] Rate Protected Shippers point out that El Paso cites no authority for the proposition that the Commission intended to confer NGA section 4 authority for purposes of this remedial remand proceeding nor does it appear that El Paso viewed itself as presenting a NGA section 4 rate filing since there were no Article 11.2(b) rates included in El Paso's direct testimony or Compliance Filing.

Commission Determination

427. The Commission affirms the Presiding Judge's choice of Trial Staff's primary remedy representing an approach that is more easily and fairly administered, neutral, and precise. The Commission agrees with the Presiding Judge that although the revenue crediting approach can achieve the same result as Trial Staff's billing determinant-based remedy, Trial Staff's approach avoids the arbitrariness of the other Participants' methods while still identifying and removing any improper cost shift to Article 11.2(b) shippers. The Commission also agrees with Trial Staff's use of system capacity rather than the cost of facilities for the 1995 system. Use of the system capacity as the starting point to calculate the remedy is consistent with the terms of the 1996 Settlement and also, as discussed more fully below, the integrated nature of El Paso's system, which cannot be physically separated into pre-1995 or post-1995 capacity.

428. We otherwise reject El Paso's proposal to adopt a value for 1995 facilities based on 1995 Form No. 2 costs updated for depreciation. El Paso has made no attempt to demonstrate that such costs represent the current costs to provide service over 1995 capacity and has provided no updated accounting reflecting current costs comparable to that typically used to establish rate base. Such an accounting would include updated facility costs reflecting additional capital costs increased by maintenance, repair and replacement costs.

429. Trial Staff's primary remedy calculates Article 11.2(b) rates by increasing the billing determinants, taken from El Paso's Compliance Filing, up to the level of the adjusted threshold.[670] Consistent with Opinion No. 517, Trial Staff reduces the 4,068,000 Dth/d threshold level by the amount of capacity reserved for nominations of

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[669] *Id.* at 47 (citing *Transcontinental Gas Pipe Line Corp. v. FERC*, 485 F.3d 1172, 1176, 1180-81 (D.C. Cir. 2007)).

[670] Rates are calculated by dividing cost of service by the billing determinants, thus, increasing the billing determinants for Article 11.2(b) shippers has the effect of lowering rates.

El Paso's hourly services (capacity reservation nominations or CRNs) to calculate the adjusted threshold level of billing determinants which represents the level that does not include costs prohibited by Article 11.2(b).[671] Trial Staff subtracted the CRN level of 356,078 Dth/d in the Compliance Filing to reach the adjusted threshold level of 3,711,922 Dth/d.

430. Trial Staff's remedy utilizes the underlying assumption that the costs of unsubscribed and discounted 1995 capacity can be derived using the difference between the billing determinants upon which El Paso's Compliance Filing rates are designed and the adjusted presumption threshold of 3,711,922 Dth/d. Trial Staff calculated Article 11.2(b) rates for each of the three sets of *pro forma* recalculated rates and work papers in El Paso's Compliance Filing: (a) those related to the Opinion No. 528 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.[672]

431. The first two rate periods include El Paso's discount cost adjustment proposal as originally filed,[673] while the third time period reflects El Paso's implementation of the Commission's discount cost allocation findings in Opinion No. 528, reflecting El Paso's prospective application of the Commission's zonal discount adjustment determination under section 5 of the NGA. To calculate the revenue shortfall for each rate period, Trial Staff calculated the difference between the recourse revenues derived from recourse rates in El Paso's Compliance Filing and the Article 11.2(b) revenues based on Article 11.2(b) rates derived through imputed billing determinants up to the 3,711,922 Dth/d revised threshold. Trial Staff calculated a cost shift of $3,169,715 for the rate period effective April 1, 2011 to September 14, 2011; $6,850,954 for the rate period effect September 15, 2011; and $5,748,370 for the prospective period.[674]

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[671] CRNs represent additional capacity set aside over the shippers' daily transportation contract entitlements to provide for the hourly fluctuations required by hourly service. CRNs represent capacity that is already sold to hourly service shippers and cannot be re-sold to other shippers. Thus, the Commission has determined CRNs to be subscribed capacity for purposes of Article 11.2(b) and counted these volumes toward the 4,068,000 Dth/d threshold.

[672] *See* Ex. S-2R.

[673] Trial Staff Initial Brief at 16.

[674] Trial Staff Brief Opposing Exceptions at 13-14.

432. The Commission affirms the Presiding Judge's finding that Trial Staff's remedy is straightforward, objective, and ultimately complies with Article 11.2(b) and previous determinations in Opinion Nos. 517 and 528. Trial Staff's remedy avoids unnecessary arbitrariness and is more easily and fairly administered than the revenue crediting-approach of the other Participants from this proceeding. We do not believe that Trial Staff's methodology is flawed, as El Paso suggests, because the shortfall necessarily includes a mix of 1995 capacity costs and post-1995 expansion costs, reflected in the discounts to be corrected. While it is true that rates on El Paso's integrated system contain a mix of 1995 and post-1995 facility costs, we do not believe that it is accurate to differentiate such costs in the manner advocated by El Paso. El Paso's approach to limit 1995 capacity costs to costs found in El Paso's 1995 Form No. 2 excludes costs to maintain, upgrade and replace and repair facilities related to 1995 capacity. That is, El Paso's approach assumes that no PIP costs were expended to maintain 1995 capacity. Such an assumption appears unsupported, given that one would expect a long-term maintenance project to be focused on older, more heavily utilized facilities which are frequently in greater need of repair.

433. Furthermore, we find El Paso's criticism that Trial Staff's approach overstates the cost of depreciated 1995 facilities supporting the 1995 capacity to be unfounded. El Paso operates an integrated system. The cost to provide service over its facilities is identified in its rates on an undifferentiated basis. Furthermore, though it may be the case that the amounts to be corrected under Trial Staff's methodology could be seen to include a mix of both pre and post-1995 facilities, such an interpretation is inconsistent with the operation of the 4,000 MMcf/d threshold adopted in the March 20 Order. This is for two reasons. First, the need for a correction does not arise until El Paso's level of discounted and unsubscribed capacity results in total firm reservations at maximum rates that fall below the 4,000 MMcf/d threshold. Thus, a consequence of the Commission's adopting the 4,000 MMcf/d threshold is to assume that discounts and undersubscriptions of system capacity above the threshold amount do not represent a transfer of 1995 system costs (whereas the realities of El Paso's integrated system may suggest otherwise). Second, while the first 550 MMcf/d or so of integrated system discount and unsubscribed capacity costs do not affect the remedy, the discount adjustments and unsubscribed capacity costs that would otherwise be transferred to Article 11.2(b) shippers necessarily include 1995 capacity costs, due to the integrated nature of El Paso's system. In the absence of reliable accounting data, we find that Trial Staff's remedy, in conjunction with the wholesale exclusion of the first 550 MMcf/d of discounted and unsubscribed capacity costs results in a balanced approach that ensures that shippers protected by Article 11.2(b) are not charged 1995 capacity costs.

434. The revenue crediting approaches advocated by El Paso, SoCal Gas/San Diego, and Rate Protected Shippers measure "the difference in revenue generated from the actual discounted rate in these contracts as compared to revenues that would have been generated had they been sold at the Article 11.2(a) rate."[675] The Participants proposing a revenue crediting approach each start with the capacity shortfall, which "is the amount of additional capacity that, if sold at or above the Article 11.2(a) rate in the first instance, would cause [El Paso] to be in compliance with Article 11.2(b)."[676] The Participants then determine the revenue deficiency by filling the capacity shortfall with discounted contracts. El Paso and SoCal Gas/San Diego fill the shortfall by sequencing El Paso's discounted contracts from highest to lowest rate until the 4,068,000 Dth/d capacity threshold is met.[677] El Paso also included interruptible revenues derived from 1995 capacity arguing that interruptible revenues also cover the cost of 1995 capacity.[678] El Paso generated $20 million in revenues derived from interruptible transportation and park and loan services and determined the pro-rata portion to be counted toward the threshold by dividing the 1995 capacity by post-1995 capacity to determine the ratio of 1995 capacity to total system capacity.[679]

435. The Commission affirms the Presiding Judge's conclusion that El Paso's proposal to include interruptible revenues to offset the remedy is inappropriate. El Paso includes a cost-of-service revenue credit for its interruptible revenues in its Compliance Filing, which acts as a reduction to its cost of service and benefits all shippers who pay recourse rates. As the Presiding Judge found, El Paso's proposal to use interruptible revenues to offset an Article 11.2(b) remedy would unjustly preclude protected shippers from enjoying the benefit of the credit that all other shippers receive.[680]

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[675] Remand Decision, 148 FERC ¶ 63,014 at P 118 (citing El Paso Initial Br. at 34; Ex. EPG-1R at 56).

[676] *Id.* P 154 (citing Rate Protected Shippers Initial Br. at 32).

[677] *Id*. P 155 (citing El Paso Initial Br. at 38).

[678] *Id.* P 172 (citing El Paso Initial Br. at 44).

[679] Ex. EPG-16R at 37-38. 4,000 MMcf/d ÷ 4,550 MMcf/d = 0.88 ratio of 1995 capacity to total system capacity. El Paso thus applies 88% to the $20 million interruptible revenues and attributes $17.5 million in interruptible revenues to 1995 capacity.

[680] Remand Decision, 148 FERC ¶ 63,014 at P 173.

436. Conversely, Rate Protected Shippers allocated shares of the gross revenue credit to "affected Article 11.2(b) shippers according to their proportion of system-wide zonal Article 11.2(b) capacity for each of the applicable compliance scenarios" in El Paso's Compliance Filing. Rate Protected Shippers calculated this by taking the shortfall quantity and dividing it by the threshold amount to derive a proportionate factor of 37.05 percent.[681] Using the proportionate factor, Rate Protected Shippers took a proportionate amount of each discounted long-term firm and short-term firm transaction below the Article 11.2(a) rate during the test period and assumed it was instead sold at the applicable Article 11.2(a) rate to calculate a total revenue credit of $37,551,384 for the Primary Case or $35,452,060 for the Alternative Case.[682]

437. The Commission affirms the Presiding Judge's finding that the "divergence and disagreement among the parties […] concerning the revenue-deficiency methodology highlights its subjectivity and arbitrariness, which Trial Staff's remedy avoids."[683] The other Participants have chosen a variety of different methods to fill the capacity shortfall (highest to lowest discounted rate contracts and use of proportionate factor). Moreover, El Paso and SoCal Gas/San Diego each fill the capacity shortfall by sequencing only long-term firm discounted contracts. When calculating revenue, however, El Paso includes long and short-term firm discounted contracts. El Paso's usage of long and short-term firm discounted contracts for its revenue calculation is inconsistent with its proposal to fill the capacity solely with long-term firm discounted contracts. Conversely, Rate Protected Shippers take a proportionate amount of each long and short-term firm discounted contract to fill the capacity shortfall.

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[681] Rate Protected Shippers Initial Br. at 32. Rate Protected Shippers calculated two proportionate factors. For their Primary Case, Rate Protected Shippers used the shortfall quantity of 614,139 Dth/d (as identified in Opinion No. 528, 145 FERC ¶ 61,040) and for their Alternative Case, Rate Protected Shippers used the shortfall quantity used by the other Participants and adopted herein of 579,805 Dth/d (using El Paso's Compliance Filing). Primary Case: (614,139 Dth/d ÷ 1,564,973 Dth/d) * 100 = 39.24 percent. Alternative Case: (579,805 Dth/d ÷ 1,564973 Dth/d) * 100 = 37.05 percent.

[682] Remand Decision, 148 FERC ¶ 63,014 at P 157 n.219 (stating that Rate Protected Shippers assert that the "proportionate amount" is "the amount in annualized average Dth/d of each contract discounted below the Article 11.2(a) rate multiplied by the proportionate factor of each discounted below the Article 11.2(a) rate multiplied by the proportionate factor." Citing Rate Protected Shippers Initial Br. at 32-33, n.70).

[683] *Remand Decision*, 148 FERC ¶ 63,014 at P 166.

438. The numerous disagreements amongst the Participants regarding which type of discounted firm contracts and calculation methods to use in their revenue-crediting approaches highlight the subjectivity and arbitrariness of the revenue-crediting approach. The Commission finds that the revenue crediting-approaches of the other Participants suffer from unnecessary arbitrariness because they each must choose which discounted contracts to apply to meet the threshold and provide opportunity and incentive for Participants to cherry pick the contracts selected to fill the shortfall according to their natural desire to minimize their economic cost. Those Participants also fail to demonstrate that Trial Staff's primary remedy should not be implemented.[684] Trial Staff's billing determinant method, on the other hand, avoids those deficiencies and creates a straight-forward methodology.

439. As for El Paso's "equitable factors," El Paso has, in various contexts, promoted the narrative that it was forced to build capacity in order to meet the demands of its customers, who then failed to continue to subscribe to the increased service volumes. Thus, in El Paso's view, it would be inequitable to permit the customers to require El Paso to build capacity to meet the demands of the former requirements customers, but relieve them of responsibility to pay for the expansion by operation of Article 11.2(b). We disagree that Article 11.2(b) or the events following the 1996 Settlement's execution bound the protected customers to maintain a given level of service or otherwise revised the bargain expressed in the 1996 Settlement. While the Commission made no findings of responsibility in earlier proceedings to address El Paso's service curtailments when it was unable to meet long-term full-requirements customers' expanding needs, we note that the Commission has elsewhere rejected reliance on El Paso's narrative, recently in Opinion No. 517-A. There the Commission stated:

> As the Commission pointed out, the U.S. Court of Appeals for the D.C. Circuit 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

[684] The Commission disagrees with El Paso's suggestion that its proposal be granted deference as if it were a NGA section 4 rate filing. The Commission has previously determined that the terms of the 1996 Settlement, including Article 11.2(b), are just and reasonable and the issue in the remand proceeding is whether El Paso's 2011 Rate Proposal meets the requirements of Article 11.2(b) and, if not, what needs to be done to ensure that the rates are consistent with that provision.

> implemented a reasonable way to do so. After the initial term of the 1996 Settlement expired, those former full requirements shippers using expansion capacity began paying recourse rates for that capacity. Thus the former full requirements shippers have not improperly avoided paying for expansion capacity, since those receiving service on expansion capacity are paying the full recourse rate for such capacity.[685]

440. Consequently, we decline to follow El Paso's train of equitable arguments to find that customers protected by the 1996 Settlement improperly induced El Paso to expand its system capacity, while impermissibly falling back on the terms of Article 11.2(b) to shield them from having to pay for the expansions.

441. Therefore, the Commission finds Trial Staff's primary billing determinant remedy is just and reasonable, clear and objective in its application, and conforms to previous Commission determinations. The Commission affirms the Presiding Judge's decision that other Participants' remedies, while achieving a similar result as Trial Staff's primary remedy, lack objectivity and are more difficult to administer.

IV. Compliance Filing – Docket No. RP10-1398-000

442. Opinion No. 528 required El Paso to file, within 60 days of the issuance of the opinion, revised *pro forma* recalculated rates consistent with the terms of the opinion. The Commission required El Paso to (a) provide work papers in electronic format, including formulas, reflecting each of the adjustments required by the opinion, (b) to compare the revised rates to those required by Opinion No. 517, and (c) provide recalculated rates identifying the rate impact of each rehearing request item at issue, with supporting work papers in electronic format, including formulas. The Commission stated that Participants to this proceeding should file any comments on El Paso's Compliance Filing within 30 days of the date of the filing.

443. On December 16, 2013, El Paso submitted its Compliance Filing in Docket No. RP10-1398-000 to comply with the Commission's directives in Opinion No. 528. The filing contains *pro forma* rates and work papers to reflect the Commission's findings effective: (a) April 1, 2011; (b) September 15, 2011, to reflect the abandonment of the Tucson and Deming Compressor Stations; and (c) prospectively, to reflect findings under NGA section 5. El Paso also included recalculated rates and work papers to reflect the

[685] Opinion No. 517-A, 152 FERC ¶ 61,039 at P 247 (citing Opinion No. 517, 139 FERC ¶ 61,095 at P 244; *Freeport*, 669 F.3d 302 at 309).

rate impact for each of the issues El Paso raised on rehearing for each of these time periods.

444. El Paso notes that it considers that the Commission's finding, requiring El Paso to allocate the cost of discounts solely to the zone in which the discount was given, was made under NGA section 5, and has included rates based on that ruling in the prospective rate section. Out of an abundance of caution, El Paso included alternative April 1, 2011 rates if the Commission disagrees. Also, because the Commission's ruling on the allocation of discounts increases some rates and decreases others, El Paso requests that it be permitted to implement the rate increases and decreases simultaneously, either retroactively under section 4 or prospectively under section 5 of the NGA. In addition, El Paso has removed the separately stated Ten-Year Rate, stating that this rate was developed using a lower cost of service than the cost of service underlying the originally-filed maximum recourse rates and was contingent on the acceptance of El Paso's filed rates. Since the maximum recourse rate is lower than El Paso's filed Ten-Year Rate, there is no longer a difference between the two rates.

445. Protests were filed by the CPUC, Southwest Gas, and SoCal Gas/San Diego. Comments were filed by El Paso Electric, Golden Spread, Indicated Shippers, New Mexico Gas, Southwestern, Texas Gas Service, and UNS/Tucson Electric.[686] The protestors raise issues about how El Paso implements the discount cost allocation, whether El Paso properly calculated its rates, and whether El Paso fully complied with Opinion No. 528.

446. El Paso filed an answer on January 29, 2014. Answers to El Paso's answer were filed by El Paso Electric and Indicated Shippers on February 12, 2014 and February 14, 2014, respectively. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure[687] prohibits an answer to a protest unless otherwise ordered by the decisional authority. The Commission will accept the answers because they have provided information that aids the Commission in its decision-making process.

<u>Commission Determination</u>

447. The Commission finds that El Paso has complied with the directives of Opinion No. 528, as discussed below.

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[686] *See* Texas Gas Service, August 4, 2014 notice of withdrawal, and July 1, 2014 settlement in Docket No. RP14-1088-000.

[687] 18 C.F.R. § 385.213(a)(2) (2015).

A. Discount Cost Allocation

448. A number of Participants question whether El Paso properly implemented the Commission's discount cost allocation findings. Southwest Gas and El Paso Electric argue that El Paso incorrectly implements the discount cost allocation prospectively under NGA section 5. The CPUC, Indicated Shippers, SoCal Gas/San Diego, and Southwestern protest El Paso's alternate request to implement retroactive rate increases if the Commission determines the discount cost allocation finding was done under NGA section 4.

449. Southwestern and Golden Spread argue that the result of the discount cost allocation is an abrupt, unforeseeable, unjustified, and substantial increase to the Within Basin rates that should not be allowed without a full consideration of intervening circumstances or mitigating factors. El Paso Electric argues that the Compliance Filing does not meaningfully mitigate the proposed cost shifting to the East of California shippers as the Opinion No. 528 expected.[688] El Paso Electric argues that El Paso's use of billing determinants in its September 16, 2011 adjustments to the 45-Day Update filing data vitiated the benefit of using billing determinants unadjusted for discounting for zone cost allocation. El Paso Electric argues that El Paso's Compliance Filing now shows nearly 800,000 Dth/d of unsubscribed capacity for which related costs are shifted to captive recourse rate shippers, which is a substantial increase from the level of unsubscribed capacity included in the April 1, 2011 Motion Rates Filing. While El Paso Electric acknowledges that the Commission affirmed the Initial Decision's finding that El Paso is entitled to a full discount adjustment and recovery of costs related to unsubscribed capacity, El Paso Electric explains that the impact of the unsubscribed capacity was not known until El Paso filed its Compliance Filing. El Paso Electric comments that the Commission must consider these comments in order to make good on its ruling to mitigate cost shifting to the East of California rate zones.

450. As discussed earlier, the Commission is granting rehearing on the discount cost allocation issue. The issues raised on this issue in the Compliance Filing are thus moot.

B. Rate Calculations

451. El Paso Electric argues that El Paso should have used the average zone mileages from the Dth-mileage study as filed. Instead of using 406 miles of haul to the Texas zone

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[688] Opinion No. 528, 145 FERC ¶ 61,040 at P 392 ("… El Paso's use of discount adjusted billing determinants to allocate costs has had the effect of shifting costs to the East of California zones. Our decision to require the use of unadjusted billing determinant for allocation purposes should mitigate this effect").

(from the Dth-mileage study), El Paso uses 484 miles in its Compliance Filing, a 19.2 percent increase. El Paso Electric states that El Paso's position is that miles of haul could be updated if needed based on Commission decisions in this proceeding. However, El Paso Electric argues that nothing in Opinion No. 528 required or permitted El Paso to make any changes to its average zone mileages.

452. The Commission disagrees with El Paso Electric's position that the as-filed mileage should be used. In Opinion No. 528, the Commission required El Paso to use actual annualized end-of-test-period billing determinants.[689] The Commission finds that the rates in El Paso's Compliance Filing were appropriately updated to use the annualized end-of-test-period billing determinants.

453. Southwest Gas argues that the Commission required El Paso to credit short-term revenues after zonal allocation and that El Paso has incorrectly credited short-term firm revenues before allocating the costs of discounts to zones. El Paso answers that there is no such directive in Opinion No. 528 and that it would not make sense to require a credit after cost allocation because credited revenues represent an offset to costs. El Paso contends that either costs are allocated or revenues are credited, but not both. The Commission agrees. The Commission in Opinion No. 528 accepted El Paso's proposal to credit its cost of service by the revenues received for short-term volumes.[690] El Paso's Compliance Filing is consistent with that finding. As El Paso notes, Southwest Gas' argument is essentially that the Commission should have applied its ruling to short-term discounted contracts in Opinion No. 528. This argument should have been raised as a request for rehearing rather than a protest to a compliance filing.

454. UNS/Tucson Electric argue that El Paso's inclusion of short-term firm billing determinants in its zonal average miles of haul calculation is inconsistent with the application of the discount adjustment where there is a credit to the cost of service for short-term firm revenues. UNS/Tucson Electric argue that to be consistent with the Commission's discount cost allocation finding, only long-term firm billing determinants should be included in the zone miles-of-haul calculation. El Paso answers that there is no inconsistency between its treatment of short-term contracts in the mileage computation as compared to the discount cost allocation because these processes serve different purposes. El Paso explains that crediting short-term revenues to the cost of service is an accepted methodology for implementing a discount adjustment that was unopposed in this case and approved by the Commission. A miles-of-haul study, on the other hand, is used to allocate mileage-related costs.

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[689] *Id.* P 207.

[690] *Id.* P 211.

455. The Commission agrees that El Paso properly included short-term firm billing determinants in its miles-of-haul calculation. As El Paso explains, the term of a contract is irrelevant to a mileage study used to determine how to allocate distance-based costs; short-term firm revenues are thus appropriately spread across the system through a revenue credit while mileage-based costs of providing short-term firm service are appropriately included in a mileage-based allocation.

456. Southwest Gas argues that El Paso did not use the approved weighted premium factors it used in its April 1, 2011 compliance rates to calculate premium hourly service rates. Using El Paso's compliance rates, Southwest Gas deduced the weighted premium factors for each service and concludes that El Paso did not maintain the same weighted premium factors relationship when calculating premium hourly service rates for the prospective period. El Paso answers that Southwest Gas' calculation of the premium factors is not accurate with respect to the prospective case because Southwest Gas does not reflect the fact that Opinion No. 528 directs that the prospective rates be designed using unadjusted billing determinants in the discount adjustment. El Paso explains that this ruling requires El Paso to allocate costs on the basis of unadjusted billing determinants, but design rates on the basis of adjusted billing determinants. Thus, the premium factors for the prospective rates cannot be calculated by simply dividing the respective hourly rates by the FT-1 rate. The Commission accepts El Paso's explanation.

457. Indicated Shippers and New Mexico Gas argue that El Paso improperly used a cost of service of $620 million, adding back in the $20 million "one time management adjustment" that it had included to reduce its cost of service to $600 million in its filed and Motion rates. New Mexico Gas argues that El Paso used its rebuttal cost of service to develop the recalculated rates instead of following the Commission's directive to make adjustments to the underlying cost of service that went into effect April 1, 2011 (i.e., El Paso's Motion Rate Filing rates). El Paso answers that its compliance rates are properly based on the rate components approved in Opinion No. 528 derived from the actual end-of-test-period costs in its September 16, 2011 filing. El Paso argues that removing the management adjustment does not make the resulting rates higher than filed rates.

458. The Commission finds that El Paso properly used the rate components accepted in Opinion No. 528. No Participant objected to the Presiding Judge's reliance on test period data for the 12-month period ending March 31, 2011 to calculate El Paso's cost of service.[691] El Paso's compliance rates are thus properly based on its actual end-of-test-period cost of service as reduced by those costs disallowed by the Commission in Opinion No. 528.

[691] *Id.* P 26 n.31.

459. Southwestern argues that El Paso improperly removed its Ten-Year Rate, which El Paso proposed to calculate based on an equity return that is 23 basis points below the return used for pricing other services. Southwestern contends that El Paso's proposed lower rate for long-term contracts was accepted by Opinion No. 528 because it was not opposed by any Participant, nor was it rejected or modified by the Initial Decision or Opinion No. 528. Southwestern argues that El Paso should have reflected that acceptance by including the Ten Year Rate in its Compliance Filing. El Paso answers that its Ten Year Rate proposal was conditioned on approval of other rate components. El Paso states that it conditioned the rate on there being no Commission-ordered changes to its rates.[692] El Paso states that it was not willing to reduce its return on equity for this rate to further reduce the rate if the Commission ordered any changes that lowered El Paso's rates. The Commission accepts El Paso's answer.

C. <u>Data</u>

460. New Mexico Gas argues that the Commission should reject the Compliance Filing as deficient and non-compliant with Opinion No. 528. New Mexico Gas states that El Paso improperly included certain hard-coded numbers in its spreadsheets. El Paso Electric notes that the zone mileages used by El Paso in Schedule I-3 are fixed numbers that do not link to their derivations and that El Paso has not provided work papers or schedules showing the derivation of the proposed changes to zone mileages. UNS/Tucson Electric similarly argue that El Paso did not provide Schedule J-1, Workpaper 2 for the test period ending March 31, 2011 containing detailed contract data necessary to verify the contract data used in El Paso's cost allocation and rate design.

461. El Paso answers that the detailed contract data in Schedule J-1 Workpaper 2 is not needed to verify that El Paso accurately designed its compliance rates. This workpaper lists every path in every contract utilized in the design of El Paso's rates. El Paso explains that Schedule J-1, which is included in El Paso's Compliance Filing, shows the billing determinants, by rate schedule and zone, which were approved in Opinion No. 528.

462. We will accept El Paso's limited use of hard-coded numbers in its Compliance Filing. We find it reasonable for El Paso to hard code numbers in certain exhibits – for example, in place of linking detailed contract data, as in Schedule J-1, or when referencing contract billing determinants, as cited by New Mexico Gas, that can be verified without a link. As explained in Opinion No. 528, El Paso used a model for calculating contract path mileages that consisted of a series of tables showing a "node" for each physical location (meter, junction, compressor station) on the pipeline and "arcs"

[692] El Paso Answer at 14-15.

that connected those locations.[693] As a result of our rulings on other issues and the agreement of the parties to use billing determinants as of March 31, 2011, El Paso had to update its billing determinants in the Compliance Filing. It did not, however, need to update the model used for calculating contract path mileages. It is understandable that the inputs into the model are hard-coded as this model was the same model used by El Paso in its previous two rate cases.[694] By comparing the exhibits supporting El Paso's filing (Schedule I-3, Workpaper 4-10, pages 1-34 (Ex. EPG-111)) with the workpapers underlying El Paso's Compliance Filing (Section A1-1, Schedule 1-3, Workpaper 4, pages 1-33), we were able to verify that El Paso complied with the requirements of Opinion No. 528.

463. The Commission finds that the December 16, 2013 Compliance Filing submitted by El Paso satisfactorily complies with the directives in Opinion No. 528. As described above, El Paso's Compliance Filing contains various sets of rate calculations reflecting the findings of Opinion No. 528 and the rate impact of each item for which El Paso is seeking rehearing. Based on our decision to grant rehearing on the discount cost allocation methodology discussed earlier, the Commission finds that Appendix B2 of El Paso's Compliance Filing (which reflects the rate impact of the Commission granting rehearing on this issue) generates the set of rates in compliance with Opinion No. 528 and the findings of this order.

D. <u>Compliance</u>

464. Within 60 days of the date of this order, El Paso is required to file *pro forma* tariff records with rates as shown on Appendix B2 of El Paso's December 16, 2013 Compliance Filing, as further modified to reflect the findings in Opinion No. 517-A, to the extent necessary.[695] If El Paso requests rehearing of this order, it is required to provide a separate set of recalculated rates identifying the rate impact of each item at issue, with supporting work papers in electronic format, including formulas, as compared to the Appendix B2 work papers and rates.

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[693] Opinion No. 528, 145 FERC ¶ 61,040 at P 213 (citing Ex. EPG-107 at 21-22).

[694] Ex. EPG-107 at 21.

[695] 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.

465. El Paso is required to submit a separate set of recalculated rates reflecting the calculation of the Article 11.2(b) rates and refund obligations reflecting the directives in this Opinion as well as the current set of Article 11.2(b) contracts. The basis of this set of calculations should be the Appendix B2 workpapers and rates.

466. 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. The Commission will issue an order addressing El Paso's tariff and refund obligations at a later date.

The Commission orders:

(A) Rehearing is granted to permit El Paso to allocate discount adjustment costs system wide, as discussed in the body of this order.

(B) The remaining requests for rehearing of Opinion No. 528 are denied as discussed above; to the extent a rehearing request is not mentioned in this order, the request should be considered denied.

(C) Within 60 days of the issuance of this order, El Paso must file revised *pro forma* tariff records and rates reflecting the Commission's rulings in this order, as discussed above.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.