114 FERC ¶ 61,290
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

El Paso Natural Gas Company Docket No. RP05-422-000

ORDER ON POST-SETTLEMENT ISSUES

(Issued March 20, 2006)

1. On June 30, 2005, El Paso Natural Gas Company (El Paso) filed revised tariff sheets pursuant to section 4 of the Natural Gas Act (NGA). In its filing, El Paso, among other things, requested that the Commission find that Article 11 of El Paso's 1996 Settlement, which provides that rates for certain shippers would be subject to vintage or discounted rate levels in subsequent El Paso rate cases, no longer applies and that any obligations that El Paso or any other settling party had under Article 11 have been permanently extinguished and fully discharged. On July 29, 2005, the Commission issued an order[1] accepting and suspending the proposed tariff sheets, subject to refund and conditions, and establishing hearing procedures and a technical conference. In that order, the Commission stated that issues related to the continued applicability of Article 11 would be addressed after the technical conference.

2. As discussed below, after consideration of briefs filed by the parties, the Commission finds that the Commission's action in El Paso's Capacity Allocation Proceeding[2] did not abrogate Article 11.2 of the 1996 Settlement. Therefore, in accordance with Article 11.2 of the 1996 Settlement, the rates El Paso charges to its shippers with Transportation Service Agreements (TSAs) that were in effect on December 31, 1995 and that remained in effect on January 1, 2006, may not exceed the base rates established under section 3.2(a) of that Settlement applicable to service under that TSA, as adjusted for inflation under section 3.2(b), through the remainder of the term of the TSA. As further explained below, this rate cap applies to former full requirements (FR) shippers as well as contract demand (CD) shippers. Further, because Article 11.2(a)

[1] 112 FERC ¶ 61,150 (2005).

[2] *El Paso Natural Gas Co.*, 99 FERC ¶ 61,244 (2002), 100 FERC ¶ 61,285 (2002), *reh'g*, 104 FERC ¶ 61,045 (2003), *reh'g*, 106 FERC ¶ 61,233 (2004), *aff'd, Arizona Corporation Commission v. FERC*, 397 F.3d 952 (2005).

applies only to TSAs in effect on December 31, 1995, the rate cap does not apply to newly executed contracts for new services. In addition, the Commission finds that the rate cap does not apply to expansion capacity. Further, the Commission finds that, with respect to the historical CD shippers, the rate cap applies to the CDs under their 1995 TSAs, and, for the former FR shippers, to their current CDs minus the portion of those CDs made possible by the Line 2000 and Power Up capacity. The Commission also finds that pursuant to Article 11.2(b), the rates charged to eligible shippers for any service may not include any costs related to (1) unsubscribed capacity that was part of El Paso's system on December 31, 1995 or (2) any such capacity sold at a rate less than the rate cap.

3. The Commission further finds that while El Paso has not thus far presented any basis for the Commission to modify Article 11.2 of the 1996 Settlement, El Paso and the other parties may present evidence at the hearing that the rates resulting from the application of Article 11.2 are not in the public interest.

Background

A. El Paso's Section 4 Filing

4. On June 30, 2005, El Paso filed a section 4 rate case in this proceeding, as required by Article 12 of the 1996 Settlement between El Paso and its customers.[3] In its section 4 filing, El Paso proposed a number of new services, a rate increase for existing services, and changes in certain terms and conditions of service. El Paso proposed three sets of tariff sheets, *i.e.*, primary tariff sheets and first and second alternate tariff sheets. The three sets of tariff sheets propose different treatments of Article 11.2 of the 1996 Settlement. El Paso's primary tariff sheets reflect the termination of Article 11.2, the first alternate tariff sheets reflect the continued application of Article 11.2 for the eligible contract demand (CD) shippers, and the second alternate sheets reflect the continued application of Article 11.2 for all eligible shippers. With its filing, El Paso submitted testimony and exhibits to support its position that, because of actions taken by the Commission in El Paso's Capacity Allocation Proceeding,[4] Article 11 of the 1996 Settlement should no longer apply. Numerous parties filed protests to this portion of El Paso's filing.

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

[4] *El Paso Natural Gas Co.*, 99 FERC ¶ 61,244 (2002), 100 FERC ¶ 61,285 (2002), *reh'g*, 104 FERC ¶ 61,045 (2003), *reh'g*, 106 FERC ¶ 61,233 (2004), *aff'd*, *Arizona Corporation Commission v. FERC*, 397 F.3d 952 (2005).

5. In the July 29 Order, the Commission accepted and suspended the primary tariff sheets, subject to further Commission order, and stated that it would address the issue of the continued applicability of Article 11 after the technical conference. At the technical conference, procedures were adopted to give parties an opportunity to file briefs and reply briefs on this issue. Initial briefs were filed by the Arizona Corporation Commission (ACC); Aera Energy, LLC, Burlington Resources Trading Inc., and Chevron Natural Gas, a division of Chevron U.S.A. Inc. (Aera Energy); Arizona Electric Power Cooperative, Inc. (AEPCO); Arizona Public Service Company and Salt River Project Agricultural Improvement and Power District (Arizona Electrics); the Public Utilities Commission of the State of California (CPUC); El Paso; El Paso Electric Company (El Paso Electric); El Paso Municipal Customer Group (Municipal Group); Phelps Dodge Corporation and Apache Nitrogen Products, Inc. (Phelps Dodge); Public Service Company of New Mexico (PNM); Southern California Gas Company and San Diego Gas & Electric Company (SoCalGas); Southern California Edison Co. (SoCalEdison); Southwest Gas Corporation (Southwest Gas); and Texas Gas Service Company, a Division of ONEOK, Inc. (Texas Gas). Reply briefs were filed by the ACC, AEPCO, Arizona Electrics, Aera Energy, the CPUC, El Paso, El Paso Electric, Municipal Group, PNM, SoCalGas, SoCalEdison, Texas Gas, and UNS Gas, Inc. (UNS Gas).

6. In its pleadings, El Paso argues that Article 11.2 of the Settlement no longer applies to any shipper because of the changes to the other aspects of the 1996 Settlement and to El Paso's contracts ordered by the Commission in the Capacity Allocation Case. Further, El Paso argues that, even if Article 11.2 were deemed to apply to the historical CD shippers, it no longer applies to the former FR shippers because the Commission abrogated the FR contracts in the Capacity Allocation Proceeding. In addition, El Paso asserts that, even if the Commission determines that Article 11.2 continues to apply, it must conclude that Article 11.2 does not apply to contracts for new services or to expansion or turnback capacity. El Paso argues that the calculation and design of the rates should be addressed at the hearing.

7. The CPUC and SoCalGas support El Paso's view that Article 11 no longer applies, at least with regard to the former full requirements contracts. Aera Energy argues that Article 11.2 no longer applies to the former full requirements contracts, but that El Paso has a legal obligation to comply with Article 11.2 for the qualifying contract demand shippers. SoCalEdison takes no position on the applicability of Article 11.2 but argues that, in the event that the Commission finds that Article 11.2 is still in effect, El Paso should not be allowed to shift costs to other shippers.

8. On the other hand, the ACC and the former full requirements (FR) shippers, *i.e.*, AEPCO, the Arizona Electrics, El Paso Electric, Municipal Group, Phelps Dodge, PNM, Southwest Gas, Texas, and UNS Gas, argue that Article 11.2 of the Settlement continues to apply to the rates of all eligible shippers, including the former FR shippers.

B. The 1996 Settlement and the Capacity Allocation Proceeding

9. El Paso's 1996 Settlement and the Commission's orders in El Paso's Capacity Allocation Proceeding are central to the Commission's decision here, and therefore we include a brief discussion of these matters at the outset.

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

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

12. The 1996 Settlement further provided for rate certainty for the ten-year period in the form of a rate cap. The base settlement rates and charges were capped for ten years, subject to an annual inflation adjustment. Full requirements customers, who did not have fixed contracted quantities, agreed to fixed annual revenue requirements from which monthly payments and billing determinants were derived. Those billing determinants and revenue requirements did not change throughout the 10-year settlement, regardless of the actual level of service taken by the full requirements customers. Thus, the charges paid by full requirements shippers were constant throughout the Settlement, even as their demands grew.

13. In its order accepting the Settlement, the Commission concluded that the Settlement was a reasonable resolution of the excess capacity crisis facing El Paso's system at that time. However, in the first several years of the Settlement period, circumstances on El Paso's system changed dramatically. The turned-back capacity was

[5] See 79 FERC ¶ 61,028, *reh'g denied,* 80 FERC ¶ 61,084 (1997).

resold, and the full requirements shippers' load grew substantially to amounts far in excess of the shippers' billing determinants.[6] There was no longer sufficient capacity to meet the demands of all firm shippers, causing routine reductions to firm customers' service requests. Firm service on El Paso's system was no longer reliable.

14. In response to the routine cuts in firm service that were taking place on the El Paso system, three separate shipper groups filed complaints concerning capacity allocation issues.[7] In addition, the Commission directed El Paso to file a systemwide capacity allocation proposal in El Paso's Order No. 637 proceeding. On May 31, 2002, the Commission issued an order in the Capacity Allocation Proceeding that addressed the complaints and established a framework for resolving the capacity allocation problems that had rendered firm service on El Paso unreliable.[8] To restore reliable firm service on El Paso, the May 31, 2002 Order, among other things, directed that El Paso convert service under full requirements contracts to service under contracts with specific contract demand limits up to El Paso's available capacity so that service to one firm shipper would not adversely affect firm service to others. The Commission found that modification of the 1996 Settlement was in the public interest, to the extent necessary to restore reliable firm service. However, the Commission modified the Settlement only to the extent necessary to restore reliable firm service on El Paso, and stated that the remainder of the Settlement would remain in place.[9] The conversion of FR service to CD

[6] 99 FERC ¶ 61, 244 at 62,002-03.

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

[8] 99 FERC ¶ 61,244 (2002), *reh'g*, 104 FERC ¶ 61,045 (2003), *reh'g*, 106 FERC ¶ 61,233 (2004), *aff'd, Arizona Corporation Commission v. FERC*, 397 F.3d 952 (D.C.Cir. 2005).

[9] 99 FERC ¶ 61,244 at 62,018.

service became effective on September 1, 2003. The Commission's decision in the Capacity Allocation Proceeding was affirmed by the court in *Arizona Corporation Commission v. FERC*.[10]

15. The Commission's action in the Capacity Allocation Proceeding was narrowly focused on restoring reliability to El Paso's system. The continued applicability of Article 11.2 after the expiration of the remaining terms and conditions of the Settlement was not at issue in that case. However, several East of California (EOC) shippers raised the issue in a request for clarification in a related El Paso proceeding.[11] In response, the Commission stated that it was premature at that time to address the issue of the continuing applicability of Article 11, and that the appropriate forum to address rate issues would be in El Paso's next section 4 rate proceeding.[12]

C. Relevant Settlement Provisions

16. Article 11.2 of the 1996 Settlement contains provisions applicable to the rates to be paid by certain shippers in the post-settlement period, *i.e.*, after December 31, 2005. Article 11.2 provides:

> 11.2 Firm TSAs [transportation service agreements] 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:
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> (a) Base Settlement Rates 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

[10] 397 F.2d 952 (D.C. Cir. 2005).

[11] On August 13, 2004, in El Paso's Docket No. RP04-110-000, the Arizona Electrics filed a motion for clarification that the conversion to CD service should not change the calculation of the rate cap.

[12] 109 FERC ¶ 61,359 at PP 23-24 (2005).

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 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).

(c) Following the term of this Stipulation and Agreement, any Shipper to which this paragraph 11.2 applies may, at the end of the primary or rollover term of its TSA, reduce its billing determinants or CD without losing the protection of this paragraph 11.2. At the request of any Shipper, El Paso will amend the Shipper's TSA to include the provisions of this paragraph 11.2.

(d) Termination by El Paso of the TSA of a Shipper subject to this paragraph 11.2 shall not terminate such Shipper's rights to the protections afforded by this paragraph 11.2.

17. Thus, under the terms of Article 11.2(a), El Paso agreed to continue the 1996 Settlement rates, as escalated for inflation in accordance with Paragraph 3.2(b), for contracts that were in effect at the time of the Settlement and that remained in effect on January 1, 2006, unless and until the Shipper terminates its TSA. In addition, Article 11.2(b) of the Settlement provides that the rates for any services to these shippers will not include any charges related to the capacity on El Paso's system on December 31, 1995 that becomes unsubscribed or discounted below the rate cap in the future.

18. Article 9.1 of The Settlement is also relevant and provides:

9.1 Billing Determinants and Contract Demand Agreed to for Settlement Term. Absent the mutual agreement of El Paso and the shipper involved, the contract demand (CD) and billing determinants on which the settlement rates are based shall not be changed during the term of the Stipulation and Agreement except to the extent of a contract termination or step-down as described in Pro Forma Tariff Sheet No. 311, Section 254.1(a)(iii), attached hereto under Tab 4, or as provided in the Article IX.

Discussion

19. As discussed below, the Commission finds that nothing in the Capacity Allocation Proceeding resulted in the abrogation of Article 11.2 of the 1996 Settlement, and the Commission finds no basis in the record developed thus far in this proceeding for concluding, pursuant to the *Mobile-Sierra* doctrine, that Article 11.2 of the Settlement is not in the public interest. Therefore, the Commission concludes that the rate cap continues to apply to eligible shippers, including the former FR shippers. The Commission further concludes that the Article 11.2(a) rate cap does not apply to new services or to expansion capacity. The Commission also finds that, with regard to the former FR shippers, the rate cap applies to their current CDs, minus the portion of those CDs that is provided by expansion capacity. Further, the Commission finds that pursuant to Article 11.2(b), rates charged to eligible shippers for any service may not include any costs related to unsubscribed capacity that was part of El Paso's system on December 31, 1995 or such capacity sold at less than the rate cap.

20. The Commission further finds that certain issues involving the application of the rate cap should be addressed at the hearing established in this proceeding in the July 29, 2005 Order. These issues include whether any costs associated with El Paso's 1995 capacity have been improperly included in the rates of eligible shippers, whether El Paso is entitled to a discount adjustment for the capped rates, and how to calculate the rate for each shipper applying the guidelines set forth here. In addition, while the Commission finds that there is no basis for abrogation of the Settlement pursuant to the *Mobile-Sierra* doctrine at this time, the parties may address at the hearing the issue of whether the rates that result from application of Article 11.2 are contrary to the public interest.

A. The Commission's Action in the Capacity Allocation Proceeding Did Not Abrogate Article 11 of the 1996 Settlement

21. El Paso argues that Article 11.2 of the 1996 Settlement no longer applies to any shipper because the terms of the 1996 Settlement were a non-severable package deal which was fundamentally altered to El Paso's detriment by the Commission in the Capacity Allocation Proceeding. El Paso states that in that proceeding, the Commission required El Paso to provide to the former full requirements shippers 550 MMcf per day of expansion capacity at El Paso's expense and 450 MMcf per day of turned-back capacity that it would otherwise have been entitled to remarket. El Paso states that this requirement to provide 1 Bcf of free capacity caused it to absorb more than $250 million[13] in expansion and other costs that it otherwise had a right to recover under the 1996 Settlement. El Paso states that in light of this subsidy it has been required to

[13] El Paso states that its testimony, Exh. No. EPG-77, documents foregone revenues of approximately $294 million.

provide shippers in derogation of the bargain it made under the 1996 Settlement, it would be inequitable to require El Paso to provide an additional subsidy through the application of Article 11.2.

22. The CPUC agrees with El Paso that due to the changed circumstances on the El Paso system, the Commission should conclude that Article 11.2 no longer applies to future rates and terms and conditions of service on El Paso's system. Similarly, SoCalGas states that the remedy chosen by the Commission to restore firm service on El Paso is inconsistent with giving continued effect to the rate cap provisions of the Settlement.

23. On the other hand, the ACC, Aera Energy,[14] and the former FR shippers, *i.e.* AEPCO, Arizona Electrics, El Paso Electric, Municipal Group, Phelps Dodge, PNM, Southwest Gas, and Texas Gas, argue that the Commission's actions in the Capacity Allocation Proceeding did not abrogate the provisions of Article 11, and that its provisions remain in effect during the post-settlement period. These parties argue that the protections of Article 11.2 were an essential *quid pro quo* for their agreement to share the costs of El Paso's turnback capacity. They state that they paid substantial consideration for the Settlement rate protections and are now entitled to receive the rate protections for which they paid. These parties argue that the fact that El Paso may have lost some benefits under the Settlement is irrelevant, and that shippers have also lost some of the anticipated benefits of the Settlement.

24. Commission Response. The Commission finds that nothing in the Commission's action in the Capacity Allocation Proceeding abrogated Article 11 of the Settlement at that time or justifies its abrogation now. The Commission explained in the Capacity Allocation orders that its policy is to encourage settlements and that the Commission is extremely reluctant to alter a settlement while it is in effect.[15] The Commission found that extraordinary circumstances existed on El Paso at that time that required the modification of the FR contracts.

25. However, the Commission made clear in the Capacity Allocation orders that it was taking limited action, and modified the Settlement and the FR contracts only to the extent necessary to restore reliable firm service on El Paso and eliminate the routine

[14] As discussed below, Aera Energy argues that the provisions of Article 11.2 continue to apply to the historical CD customers, but not to the former FR customers.

[15] 99 FERC ¶ 61,244 at 62,008.

pro rata cuts in firm service that had made that service unreliable.[16] Thus, the Commission directed that FR service be converted to CD service.

26. In taking steps to assure that the former FR shippers would receive reliable firm service under their new CDs, the Commission explained that, while the decision whether to build additional capacity is a business decision that is left to the pipeline in the first instance under the NGA,[17] in this case El Paso had recently added an additional 230 MMcf/d on Line 2000 and committed to further expand its capacity by implementing its Line 2000 PowerUp Project. El Paso had informed the Commission that this additional capacity, in combination with the proposal to convert FR contracts to CD contracts, would eliminate the need for pro rata allocations except in cases of *force majeure*. Further, El Paso stated that it was willing to forgo cost recovery for the projects until its next rate case,[18] and the Commission accepted El Paso's commitment.[19] El Paso's commitment was not in any way related to modification of Article 11, and the Commission's action in the Capacity Allocation Proceeding provides no basis for finding that Article 11 no longer applies.

27. Further, in adopting its surgical approach to the Settlement modification, the Commission specifically addressed the question of whether, instead of making only these limited changes to the Settlement, it should abrogate the entire Settlement. Several of the former FR shippers argued that once the Commission had decided to modify the 1996 Settlement in part, it erred by failing to terminate the Settlement in its entirety because the Commission's actions had eliminated the benefits of the Settlement for the FR shippers. SoCalEdison also argued that the Commission should abrogate the entire Settlement, alleging that the Commission's actions had benefited the FR shippers by giving them preferential rates. The Commission concluded that the facts and the law did not support abrogation of the entire Settlement.[20] El Paso never argued to the Commission that Article 11 or any other provisions of the Settlement should have been

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[16] *Id.* at 62,008 (The Commission has attempted to minimize changes to the Settlement while taking action to alleviate reliability problems). *See also*, 104 FERC ¶ 61,045 at P 173.

[17] 99 FERC ¶ 61,244 at 62,012.

[18] *See* 99 FERC at 62,024.

[19] 104 FERC ¶ 61,045 at P 109. See also *El Paso Natural Gas Co.*, 103 FERC ¶ 61,280 (2002).

[20] *El Paso Natural Gas Co.*, 104 FERC ¶ 61,045 at P 93 (2003).

abrogated, and at the public conference stated that the bargains of the Settlement should be retained to the greatest extent possible.[21] El Paso did not seek rehearing of the Commission's ruling.

28. Moreover, as the Commission explained in the Capacity Allocation Proceeding, in devising its remedy for the reliability problems on El Paso, the Commission balanced the interests of all of the parties to that proceeding, as well as considering the public interest.[22] Thus, contrary to El Paso's assertion, it was not only El Paso whose expectations under the Settlement were altered. The expectations of the FR shippers were changed when their service was converted to CD service and the expectations of the CD shippers were changed during the term of the Settlement when their firm service was subjected to routine cuts to firm nominations. No party can simply withdraw from a Settlement because it has not turned out to be as beneficial as originally anticipated, and all shippers on El Paso remained subject to the terms of the Settlement despite the fact that their expectations may not have been met.[23]

29. El Paso also argues that because the Settlement was a non-severable package and El Paso could have withdrawn from the Settlement if the Commission had made these same changes prior to the effective date of the Settlement, it is also true that the Commission could not fundamentally change the Settlement to El Paso's detriment after the Settlement became effective while requiring El Paso to continue to perform under Article 11.2.[24] The fact that the Settlement contains in Article 17 a fairly standard provision that would have allowed El Paso to withdraw the Settlement prior to its implementation if the Commission's approval modified the Settlement in a significant way, does not mean that El Paso or any other party can withdraw from the Settlement

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[21] See Statement of P. Shelton, President, El Paso Natural Gas, April 16, 2002 Public Conference, Docket No. RP00-336-000 at p. 12.

[22] *E.g.*, *El Paso Natural Gas Co.*, 104 FERC ¶ 61,045 at P 82.

[23] *See, e.g., Exxon Mobil Corp. v. FERC*, 430 F.3d 1166, 1175 (D.C. Cir. 2005).

[24] In addition, El Paso states that the Commission's decision in the Capacity Allocation Proceeding exposed it to new risks as a result of losing the benefits of the "sole supplier" provision of the FR contracts. However, Article 9.2 of the 1996 Settlement itself gives the FR shippers the option of converting to CD service, so there was nothing that assured El Paso that the FR shippers would remain FR shippers through the term of the Settlement. In any event, El Paso supported the conversion of FR contracts to CD contracts in the Capacity Allocation Proceeding, and never argued that the conversion would eliminate any of El Paso's obligations under the Settlement.

bargains after the Settlement was implemented.[25] Once the Settlement was implemented, all parties were bound by it, and the Settlement cannot be changed absent Commission action under section 5 of the NGA.

30. El Paso asserts in a footnote that its conclusion that it is not bound by the terms of Article 11.2 is supported by established contract law principles. El Paso cites *Williston on Contracts* and the *Restatement (Second) of Contracts* as stating that a party to a contract is excused from performing when a government order is issued that substantially frustrates a central purpose of the contract or makes performance impossible;[26] that if the performance of an essential part of the agreed exchange is unenforceable, the inequality will be so great as to make the entire contract unenforceable;[27] and that the obligations of the parties are no longer binding upon the occurrence of a condition subsequent.[28]

31. None of these citations supports El Paso's view that it no longer has an obligation under Article 11.2 of the Settlement. Section 261of the *Restatement (Second) of Contracts* cited by El Paso, which relates to the doctrine of frustration of purpose is not apposite here. First, Section 261 refers to governmental action that is not directly on the contract, but impacts its central purpose.[29] It does not address the situation here, where a regulatory agency has jurisdiction over the contract and has the statutory authority to modify the contract where the public interest so requires. Here, the Commission has, under the public interest standard, exercised its authority under section 5 of the NGA to directly modify certain aspects of the Settlement and specifically declined to abrogate the

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

[26] Specifically, El Paso cites 30 *Williston* § 77:95 (4th ed. 2004) and the *Restatement (Second) of Contracts* § 261 (1981).

[27] El Paso cites *Restatement (Second) of Contracts* § 184, comment a.

[28] El Paso cites *Public Service Company of New Hampshire*, 85 FERC ¶ 63,001 at 65,006 (1998). El Paso states that to find a condition subsequent, the ALJ in that case looked to "whether the continuance of a special group of circumstances appears from the terms of the contract, interpreted in the setting of the occasion, to have been a tacit or implied presupposition in the minds of the contracting parties, conditioning their belief in a continued obligation."

[29] *See Restatement (Second) of Contracts* § 261, Comment b, Illustration 3.

entire Settlement. Further, as the comments to the Restatement make clear, regulatory action that merely makes contract performance more onerous does not excuse performance.[30] Thus, El Paso's argument that the Commission's action in the Capacity Allocation Proceeding placed additional burdens on it does not provide a legal basis for abrogating Article 11.2. Neither does El Paso's reference to the doctrine of implied conditions. El Paso does not explain what the implied condition subsequent is in this case, and if El Paso is suggesting by reference to the ALJ's decision in *Public Service Company of New Hampshire* that there was an "implied supposition in the minds of the parties"[31] that Article 11.2 of the Settlement would no longer apply if the Capacity Allocation orders were issued, there is simply no basis for this contention. El Paso has not shown that it was the intent of the parties that Article 11 would no longer apply if the Commission made other modifications to the Settlement.

32. El Paso could have raised its arguments in the Capacity Allocation Proceeding where the Commission addressed the question of what portions of the Settlement required modification, but did not. The Commission did not modify Article 11.2 in the Capacity Allocation Proceeding and the court upheld the Commission's decision. El Paso did not seek rehearing or appeal the Commission's decision on this issue. If El Paso believes that further modification of the Settlement is required at this time, it must meet its burden of proof under the *Mobile-Sierra* doctrine that modification is required under the public interest standard. As discussed below, that burden has not been met.

B. The Record To Date in This Proceeding Does Not Justify Modification of the 1996 Settlement Under the *Mobile-Sierra* Doctrine to Eliminate Article 11.2

33. El Paso argues that the *Mobile-Sierra* doctrine does not apply to its Article 11.2 proposal because it is not seeking modification of the Settlement. Instead, as discussed above, El Paso argues that the Settlement already has been modified by the Commission's Capacity Allocation Case orders and that as a result, El Paso's former obligations under Article 11 no longer exist. However, El Paso states in a footnote that, assuming, *arguendo*, that the *Mobile-Sierra* doctrine applies, Article 11.2 is not in the public interest. El Paso states that it would be unduly discriminatory for the Commission to transfer almost $300 million of the consideration that El Paso bargained for under the Settlement to its customers, while allowing El Paso's customers to benefit from the artificially reduced rates under Article 11.2. Further, El Paso states, to the extent the Commission permits El Paso to allocate costs from capped shippers to other shippers, that reallocation could pose a substantial burden on the uncapped shippers. On the other hand, Aera Energy, the ACC, and the former FR Shippers argue that any modification of

[30] *Id.*

[31] See note 29.

Article 11.2 must be justified under the higher public interest standard of the *Mobile-Sierra* doctrine, and that the circumstances here do not justify modification under that standard.

34. As explained above, Article 11.2 of the 1996 Settlement was not modified in or as a result of the Capacity Allocation Proceeding. Further, the Commission concluded in that proceeding that the *Mobile-Sierra* doctrine applies to the decision to modify the provisions of the 1996 Settlement.[32] Thus, any further modification of the Settlement to eliminate Article 11.2 must also be evaluated under the public interest standard of the *Mobile-Sierra* doctrine.

35. The public interest is not the same as the interests of the parties to the contracts, and the Commission does not protect parties from the consequences of their bargains.[33] Therefore, it is not enough to justify contract modification that a contract has become uneconomic for one of the parties, and "the parties may be required to live with their bargains as time passes and various projections about the future are proved correct or incorrect."[34] It is also not sufficient to justify contract modification under *Mobile-Sierra* that some shippers pay a different rate under a contract or settlement agreement than other shippers on the system.[35]

36. In the Capacity Allocation Proceeding, the Commission found that there were extraordinary circumstances on El Paso at that time that required the Commission to exercise its authority under section 5 of the NGA to make limited modifications to the 1996 Settlement in the public interest. The record to date does not show such circumstances here. El Paso has not alleged any harm to the public interest caused by Article 11.2, and focuses on the impact of the provision on itself. In determining whether

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[32] 99 FERC ¶ 61,24 at 62,005.

[33] 104 FERC ¶ 61,045 at P 42 (citing *FPC v. Sierra Pacific Power Co*, 350 U.S. at 350) and P 43 (citing *Nevada Power Co. and Sierra Pacific Power Co. v. Enron Power Marketing, Inc.*, 103 FERC ¶ 61,353 (2003)); *Public Utilities Commission of California v. Sellers of Long-Term Contracts*, 103 FERC ¶ 61,354 (2003); *PacifiCorp v. Reliant Energy Services, Inc.*, 103 FERC ¶ 61,355 (2003)).

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

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

the public interest requires the Commission to take action to modify a contract or settlement because the rate is too low, the Commission considers whether the rate will impair the financial ability of the pipeline to provide service, impose excessive burdens on third parties, or be unduly discriminatory.[36] There is no basis here for the Commission to make any such finding.

37. Further, El Paso's suggestion that the public interest standard has been met here because the Commission may permit El Paso to reallocate costs from capped shippers to other shippers, and this could place a burden on those shippers is speculative and does not currently provide a sufficient basis for modification of the Settlement. Until just and reasonable rates are established in the hearing, it will not be known whether the overall rates will be greater or less than the capped rates. Further, the question of whether the other shippers on El Paso should be allocated, through a discount adjustment, costs associated with the rate cap is an issue to be resolved at the hearing. Even if a discount adjustment were permitted, that may not necessarily mean that the overall rates will be higher than the capped rates. Therefore, El Paso's allegation does not provide a basis for modifying the Settlement under the public interest standard of the *Mobile-Sierra* doctrine at this time. Similarly, there is no basis at this time for the Commission to conclude that the capped rates are too low to be consistent with the public interest. However, if El Paso or any other party believes that the rates that result from applying Article 11.2 are not in the public interest, they may argue at the hearing that Article 11.2 should be modified under the public interest standard of the *Mobile-Sierra* doctrine.

C. The Provisions of Article 11.2 Apply to the Former Full Requirements Shippers

38. El Paso argues that, even if the Commission determines that Article 11 applies to the historical CD customers, the Commission must find that it no longer applies to former FR shippers because the Commission abrogated their contracts in the Capacity Allocation Proceeding. El Paso quotes the Commission's reference to the FR shippers' contracts as "new CD contracts."[37] El Paso states that by its terms, Article 11.2 does not apply to new contracts, but only to a contract that was in effect on December 31, 1995 and that remains in effect, in its present form or as amended, on January 1, 2006. Further, El Paso asserts, the FR shippers themselves have asserted that the Commission abrogated their contracts in the Capacity Allocation Case. El Paso states that the FR contracts no longer exist and that the former FR customers now have an entirely new contractual relationship with El Paso. Aera Energy and SoCalGas support El Paso's position that the FR contracts were abrogated and that therefore the provisions of Article 11 no longer apply to the former FR

[36] *See, e.g., Northeast Utilities Service Co. v. FERC*, 55 F.3d 686, 690 (1st Cir. 1995).

[37] 104 FERC ¶ 61,045 at P 17.

shippers. On the other hand, the ACC and the former FR shippers argue that the FR contracts have not been abrogated and that the provisions of Article 11.2 continue to apply to them.

39. In the Capacity Allocation Proceeding, the Commission modified the FR contracts by changing them to CD contracts. It did not cancel, terminate, or abrogate the contracts. Specifically, the Commission directed that service under the FR contracts be "converted" to service under CD contracts. [38] The Commission made clear that it was modifying the Settlement and the contracts only to the extent necessary to resolve the capacity allocation problems on El Paso's system.[39] The contracts for CD service are a continuation of the same service that the shippers received under their FR contracts with the changes ordered by the Commission.[40] The Commission finds that they are therefore amended contracts within the meaning of the Settlement.

40. Further, the conversion of the FR contracts to CD contracts was specifically contemplated by the Settlement itself. Article 9.2 provides a shipper the right to convert from FR to contract demand service after January 1, 2002. Thus, the conversion of FR service was not unforeseen by the Settlement and such conversion does not eliminate the Settlement's protections under Article 11.2. The fact that the conversion occurred as a result of Commission orders rather than at the option of the shipper does not alter the application of Article 11.2 to converted TSAs.

41. Moreover, the Settlement provides that the provisions of Article 11 apply "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.*" (Emphasis added.) Article 11(d) of the Settlement further provides that termination of the TSA by El Paso shall not terminate the shipper's rights under Article 11. In this case, the modification of the contract was not initiated by the shipper, but was ordered by the Commission under section 5 of the NGA. The amendment of the contracts to comply with the Commission's order cannot be considered termination by the shipper of its TSA. Further, nothing in the Commission's orders required El Paso to replace the FR contracts with entirely new contracts or to make any changes to the contracts other than to implement the conversion of FR to CD service. If El Paso chose to issue new contracts, then it was El Paso's choice and cannot be considered termination by the shippers.

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[38] 99 FERC ¶ 61,244 at 62,000.

[39] 104 FERC ¶ 61,045 at P 93.

[40] 106 FERC ¶ 61,083 at P 54.

D. Implementation of Article 11.2

42. Parties have raised issues concerning the appropriate application of Article 11.2 provisions to the rates of eligible shippers. The Commission will establish in this order the general guidelines for application of Article 11.2, and will leave certain details of implementation for the parties to address at the hearing. As explained below, the Commission finds that the Article 11.2(a) rate cap applies to the continuation of service under Rate Schedule FT-1, but does not apply to contracts for new services. Further, the Commission finds that the rate cap does not apply to expansion capacity, and that it applies to the current CDs of the former FR shippers, minus the portion of those CDs that is attributable to the expansion capacity. The Commission also finds that Article 11.2(b) applies to rates for all services to eligible shippers.

43. Within this general framework, parties may address at the hearing issues concerning whether any costs associated with El Paso's 1995 capacity have been improperly included in the rates of eligible shippers, whether El Paso is entitled to a discount adjustment for any discounted rates, and how to calculate the rate for each shipper applying the guidelines set forth here.

1. Application to New Services

a. Article 11.2(a)[41]

44. In its filing, El Paso has proposed, in addition to the FT-1 service that it currently offers, a number of new services that will give shippers greater flexibility to vary their hourly takes. El Paso argues that if a shipper elects to take these new services, a new contract must be executed and the protections of Article 11 will no longer apply.

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[41]The complete text of Article 11.2 is set forth above in Section C of the order. The text of Article 11.2(a) is repeated here for the convenience of the reader:

> Base Settlement Rates 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.

45. On the other hand, the former FR shippers, *i.e.*, Arizona Electrics, El Paso Electric, Municipal Group, PNM, Phelps Dodge, Southwest Gas, and Texas Gas argue that the protections of Article 11.2(a) should apply to any contracts they execute for the new services proposed by El Paso. These parties argue that the manner in which El Paso has proposed to offer the new services is a deliberate attempt on its part to avoid its commitment under Article 11.2(a) and that this attempt should be rejected by the Commission. These shippers assert that because El Paso has proposed hourly restrictions on FT-1 service, it has thereby forced shippers to terminate their FT-1 contracts and sign new contracts under new rate schedules that permit hourly swings.

46. Arizona Electrics and Southwest Gas argue that by structuring the new hourly services as a bundled product, El Paso has forced shippers to execute new contracts for hourly services bundled with transportation services. Arizona Electrics assert that El Paso could have offered the new hourly services as an unbundled supplement to the existing FT-1 transportation service, and this would not have required termination of existing FT-1 contracts. Arizona Electrics argue that the Commission should reject El Paso's bundled approach because there is no operational or policy reason that El Paso cannot offer the new hourly services as a separate unbundled product that could be purchased as a supplement to the existing FT-1 service. Under an unbundled structure, they argue, EOC customers would not be forced to terminate their existing contracts. Further, Arizona Electrics argue that offering new services on an unbundled hourly basis is consistent with Commission policy requiring the unbundling of transportation and storage services, and will ensure that shippers subscribe and pay only for those services they need.

47. Moreover, Arizona Electrics, Municipal Group, and El Paso Electric argue that, by its terms, Article 11.2(a) would not continue to apply if the shipper cancelled its contract, but does continue to apply if El Paso, rather than the shipper, terminates the shipper's contract. They argue that if shippers are required to terminate the existing FT-1 contracts and execute new contracts for hourly services, this cannot be treated as a voluntary termination by the shippers. Arizona Electrics argue that it instead should be viewed as a unilateral termination by El Paso because, but for El Paso's rate filing, existing TSAs would not be terminated by any shipper.

48. In addition, several East of California shippers argue that Article 11.2(a) should apply to contracts for new services because the new services are replacing the shipper's existing service. PNM argues that although its original FR contract has been split into several CD contracts, its delivery points have not changed and the aggregate capacity provided under the new CD contracts does not exceed the total capacity provided for in the FR TSA. Texas Gas argues that it has been able to fulfill the obligations of its human needs customers under Rate Schedule FT-1. Texas Gas states that El Paso is here seeking to revise its tariff so that LDCs will be required to take a differently-named service in

order to receive the service they have received under Rate Schedule FT. Texas Gas argues that allowing El Paso to unbundle and rename the services the LDCs have previously received unfairly strips the LDCs of their benefits under the Settlement and is inconsistent with Article 11.2(d) which states that termination of a TSA by El Paso does not terminate the shipper's right to protection under Article 11.2.

49. Similarly, El Paso Electric argues that if former FR shippers are compelled to enter into new contracts for new services, the Commission should determine that Article 11.2(a) applies to those shippers to the extent that the total package received replaces the services provided by El Paso on December 31, 1995. El Paso Electric states that on that date, El Paso provided FR service, including swings on a daily and hourly basis, up to the meter capacity of the delivery points. The Commission should apply Article 11.2(a) to the package of new services that replace the traditional FT-1 service.

50. Commission Response. The East of California shippers are not correct in asserting that the new services offered by El Paso are the same as the FT-1 service they currently receive or that El Paso has improperly restricted the scope of the FT-1 service. As the Commission explained in *Southwest Gas Corp*.,[42] El Paso's shippers do not have the firm right to flow gas on a non-ratable hourly basis under their existing FT-1 service. In *Southwest Gas,* the Commission responded to a petition for a declaratory order to remove uncertainty concerning section 20.8 of El Paso's General Terms and Conditions which states: "[Shipper shall] endeavor to deliver and receive natural gas in uniform hourly quantities during any gas day with operating variations kept to the minimum feasible."

51. The Commission stated that while this language suggests that there is some flexibility in hourly flow requirements, the Commission has made clear that this type of language does not give the shipper a firm right to hourly variations in service. [43] Therefore, El Paso's shippers never had any firm right to engage in non-ratable hourly swings under Rate Schedule FT-1. El Paso proposes to continue to offer FT-1 service to shippers and states that FT-1 shippers will continue to be provided with a significant degree of flexibility.

52. Therefore, El Paso has not changed the nature of the FT-1 service. Shippers are free to choose to keep their existing FT-1 contracts and retain the protections of the Article 11.2(a) rate cap. However, if shippers elect to sign up for new flexible services, then a new contract for those services must be executed. Services taken under these new contracts will not meet the conditions for Article 11.2(a) protection because the new contracts are not contracts that were in effect on December 31, 1995 that remain in effect

[42] *Southwest Gas Corp*., 111 FERC ¶ 61,511 at PP 13, 15 (2005).

[43] *See, e.g., Tennessee Gas Pipeline Co*., 76 FERC ¶ 61,022 at 61,138 (1996).

on January 1, 2006. They cannot properly be viewed as a continuation or amendment of the FT-1 contracts because they are for a different service that was not previously offered by El Paso.

53. Further, there is nothing improper about El Paso's proposal to offer the new services. They are the same types of services and are offered in the same manner as the Commission has found acceptable for other pipelines.[44] Thus, El Paso is offering additional services that are similar to those offered by other pipelines and in the same manner as other pipelines have offered their services. El Paso will continue to offer FT-1 service, and shippers are free to retain all their service as FT-1. In these circumstances, El Paso's tariff filing is not a termination of existing contracts by El Paso.

b. Article 11.2(b)[45]

54. AEPCO, Arizona Electrics, and Southwest Gas argue that, regardless of the Commission's decision with respect to Article 11.2(a), the Article 11.2(b) rate protection continues to apply to any new firm services proposed by El Paso to replace the existing FT-1 service. These parties argue that Article 11.2(b) is more broadly written than the Article 11.2(a) rate cap, and by its terms applies to El Paso's new services. They argue that Article 11.2(a) protects eligible shippers under their FT-1 contracts, but that Article 11.2(b) is broader and extends protection against unsubscribed or discounted capacity to eligible shippers under all of their contracts. Southwest Gas argues that Article 11.2(b)

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[44] *See Colorado Interstate Gas Co.*, 96 FERC ¶ 61,330 (2001); *Portland Natural Gas Transmission System*, 106 FERC ¶ 61,289 (2004), *order on reh'g*, 110 FERC ¶ 61,375 (2005); and *Gulfstream Natural Gas System, L.L.C.*, 100 FERC ¶ 61,018 at P 33 (2002). The terms and conditions of the new services were discussed at the technical conference and will be addressed in a separate order on the technical conference.

[45] As set forth above, Article 11.2(b) provides:

> (b) Unsubscribed Capacity Costs. El Paso agrees that the firm rates applicable to service to any Shipper to which this paragraph 11.2 applies will exclude any cost, charge, surcharge, component, or add-on in any way related to the capacity of its system on December 31, 1995, to deliver gas on a forward haul basis to the Shippers listed on Pro 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).

applies to *shippers*, not *contracts*, and there is nothing in Article 11.2 that limits its application to only certain contracts held by eligible shippers. AEPCO asserts Article 11.2(b), unlike Article 11.2(a), applies to rates on all *services* provided to covered shippers, not just services under their 1995 TSAs. Therefore, AEPCO states, the inclusion of stranded or discounted capacity costs in rates for service to eligible shippers is prohibited to the extent that the stranded or discounted capacity was part of El Paso's system on December 31, 1995.

55. El Paso responds that this interpretation ignores the prefatory language of Article 11.2 which, El Paso states, qualifies both Article 11.2(a) and 11.2(b) and provides that the whole article only "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." (Emphasis added by El Paso.) El Paso states that because the FR contracts have been abrogated, neither Article 11.2(a) or 11.2(b) continues to apply to the former FR shippers. Thus, in El Paso's view, the provisions of both Article 11.2(a) and (b) are limited to TSAs that were in effect in 1995.

56. Commission Response. The Commission finds that Article 11.2(b) is not limited to TSAs that were in effect on December 31, 1995, but applies to rates for all firm forward haul services provided to eligible shippers. Contrary to El Paso's assertion, the prefatory language does not suggest otherwise. The first sentences of Article 11.2 provide:

> 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: …(emphasis added).

The language of the first sentence makes clear that the paragraph applies to any "Shipper," not, despite the emphasis added to the quotation in El Paso's brief, to a "TSA." The phrase "with a TSA that was in effect on December 31, 1995…" modifies the term "Shipper" to explain to which shippers Article 11.2 applies. The second sentence again refers to El Paso's agreement with respect to eligible shippers, not to specific TSAs. Therefore, the prefatory language does not, as El Paso suggests, limit both Article 11.2(a) and (b) only to specific TSAs, but clarifies that both provisions apply to shippers that have TSAs that were in effect in 1995, and remain in effect on January 1, 2006. In addition, since the prefatory language states that Article 11.2 applies "only for the period that such shipper has not terminated such TSA," it would cease to apply to any covered shipper whenever it terminates all of its eligible TSAs.

57. While, as discussed above, Article 11.2(a) applies to rates for services under specific TSAs, Article 11.2(b) addresses "the firm rates applicable to service to any" eligible shipper, and does not limit its provisions to any specific TSAs. Subsection (b) does not even mention "TSAs." Thus, it does not explicitly limit its application to specific TSAs, and the prefatory language cited by El Paso does not implicitly so limit it. Instead, the plain language of the provision makes clear that it applies to all services to eligible shippers. Further, the broad language of the last sentence of subsection (b) indicates that El Paso is assuming responsibility for all future stranded 1995 capacity with respect to these shippers without regard to specific TSAs: "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)." This broad language cannot be reconciled with El Paso's narrow interpretation.

58. Thus, Article 11.2(b) protects eligible shippers against inclusion of costs related to 1995 capacity that is unsubscribed or sold at less than the maximum applicable tariff rates as escalated pursuant to paragraph 3.2(b) of the 1996 Settlement.[46] This protection would apply to the rates for service to any shipper that has a TSA that was in effect on December 31, 1995 and remains in effect, in its present form or as amended, on January 1, 2006. As long as the shipper has not cancelled all of its eligible TSAs, the Settlement provides that the firm rates of that shipper for forward haul service cannot include costs for unsubscribed 1995 capacity or costs of such capacity sold at a rate less than the rate cap under any of that shipper's contracts. Therefore, charges for unsubscribed 1995 capacity or costs of such capacity sold at a rate less than the rate cap cannot be included in the firm rates of an eligible shipper for any forward haul services, including the new services proposed by El Paso in this rate case.

59. There are, however, limitations on the applicability of Article 11.2(b). Most significantly, it is limited to costs related to the capacity of El Paso's system on December 31, 1995, and, therefore, does not apply to costs related to any expansions made by El Paso after 1995. Thus, issues may be raised concerning whether specific unsubscribed capacity or capacity sold at a rate less than the rate cap is related to capacity that was on El Paso's system in December 1995. This would particularly be the case in areas, such as on Line 2000, where capacity has been expanded since 1995, and questions arise regarding whether the capacity that became unsubscribed or sold at a rate less than the rate cap is part of the original or the expanded capacity.

[46] The maximum contract rate refers to the rates in the 1996 settlement as escalated pursuant to paragraph 3.2(b), *i.e.*, the rate cap. Thus, a discount must reduce rates below the rate cap, not just the current maximum rate in order for the protection of Article 11.2(b) to become applicable.

60. At the time of the 1996 Settlement, the parties agreed that the capacity of the El Paso system was "slightly more than 4000 MMcf/d."[47] Therefore, in determining whether specific capacity was part of El Paso's 1995 system, the Commission will presume the first 4000 MMcf/d of firm subscribed capacity on El Paso's system is 1995 capacity. Therefore, 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.[48]

61. In addition, Article 11.2(b) applies only to firm forward haul capacity. Therefore, it does not apply to interruptible service and does not apply to service performed using a backhaul or to services such as storage or park and loan. Further, a shipper is eligible for the protection of Article 11.2(b) only for as long as it has a contract in effect that was in effect on December 31, 1995. When these contracts expire or are terminated by the shipper, the protections will no longer apply.

62. Turnback Capacity. Municipal Customers and Arizona Electrics have raised a related issue with regard to El Paso's remarketing of turnback capacity. These parties argue that El Paso's allocation of turnback capacity to new services violates Article 11.2(b) of the 1996 Settlement. They argue that Article 11.2(b) contains El Paso's pledge not to seek recovery of the costs of unsubscribed capacity again from those shippers that shared the expense in 1996. They assert that this "never again" aspect of the Settlement was critical to shippers making payments to the pipeline for unsubscribed capacity, and remains important because El Paso now has structured its new services and designed its rates in a manner that shifts the costs of turnback capacity to customers covered by the protections of Article 11.2(b). Municipal Customers assert that the provisions of Article 11.2(b) place the risk of such turnback and discounting on El Paso. Therefore, the cost of any unsubscribed or stranded capacity utilized to make the new services work should be born by El Paso's shareholders and not the signatories to the 1996 Settlement.

63. Stranded or unsubscribed capacity is excess capacity on the pipeline that is not under contract. As explained above, the Commission finds that the costs of stranded and unsubscribed capacity cannot be included in the rates of the eligible shippers under Article 11.2(b), to the extent that the stranded or unsubscribed capacity was part of El Paso's system on December 31, 1995. However, it is quite another thing to say that El Paso cannot resell that capacity packaged as new services and charge all shippers a

[47] Offer of Settlement and Request for Approval of Stipulation and Agreement at pp.5 and 7.

[48] El Paso states that the first 550 MMcf/d of uncontracted capacity and the first $65 million per year in the value of discounts is attributable to the expansion capacity and therefore outside the limitations of Article 11.2(b). El Paso states that in this rate case, Article 11.2(b) had no applicability to the rates. Palazzari, EPG-69 at 85.

reasonable rate for the new services. The capacity is not stranded if it is being used, and all shippers are required to pay reasonable rates for the services they purchase from El Paso.

2. Application of Article 11.2(a) to Expansion Capacity

64. El Paso argues that Article 11.2(a) applies only to contracts that existed in 1995 and that continue to exist today. Therefore, El Paso concludes, Article 11.2(a) could not apply to expansion capacity that did not exist when Article 11.2(a) became effective and applies only to capacity that was on El Paso's system on December 31, 1995.

65. On the other hand, Arizona Electrics, Phelps Dodge and Texas Gas argue that the rate cap applies to Line 2000 and the Power-Up expansion capacity. Arizona Electrics assert that Article 11.2(b) is specifically limited to capacity existing as of December 31, 1995, but there is no language in Article 11.2(a) limiting the rate cap to capacity in existence at the time the language was agreed to in the Settlement. Arizona Electrics argue that in the absence of any such limitation, Article 11.2(a) reflects the conscious decision of the parties that the application of Article 11.2 (a) would not be limited to capacity in existence in 1995. Further, Arizona Electrics argue that the Commission's conclusion in the Capacity Allocation Proceeding that El Paso was not required to construct new capacity does not mean that the pricing of any new capacity that El Paso did construct would be exempt from the price cap of Article 11.2(a). Similarly, Phelps Dodge argues that El Paso was not required to build Line 2000 or the Power Up Project, but voluntarily constructed them with the knowledge that they were subject to the rate Settlement agreement that defined the level of future rates for shippers.

66. In addition, Arizona Electrics argue that an exemption for expansion capacity would ignore the Commission's finding that the new Line 2000 and Power-Up Capacity were for the benefit of all system customers, rather than exclusively for FR growth. Arizona Electrics assert that if El Paso's interpretation were adopted, the East of California shippers would be denied rate cap protection for the Line 2000 and Power-Up capacity allocated to them, while the CD customers would remain fully protected, simply because newly constructed capacity is not directly allocated to their service. Arizona Electrics argue that this result would be unduly discriminatory.

67. Texas Gas states that the Line 2000 and Power-Up expansions did not provide new service, but the project provided additional capacity to meet El Paso's existing obligations. Therefore, Texas Gas asserts Article 11.2 of the Settlement applies to that capacity.

68. Commission Response. The Commission finds that the rate cap does not apply to Line 2000 or the Power Up Project. To conclude otherwise would ignore the express language of the Settlement as well as the Commission's orders in the Capacity Allocation

Proceeding and in the Power Up Project certificate proceeding. [49] As the Commission explained in the Capacity Allocation Proceeding, the 1990 and 1996 Settlements provide that El Paso does not have an obligation to construct new capacity to serve its shippers' needs at its own expense. As the Commission stated, Section 3.6 of the 1990 Settlement provides that "El Paso shall not be required to construct any facilities that are not economically justifiable. The provisions of this Section 3.6 shall survive the term of this Stipulation and Agreement."[50] The Commission explained that the "economically justifiable" language means either that any new capacity would bring increased revenues to El Paso, or that the shippers would share the expense with El Paso. Therefore, El Paso was not obligated under the Settlement or under the NGA[51] to build capacity at its own expense to meet the growth in the needs of the FR shippers and was not required to construct Line 2000 or the Power Up Project at its own expense to serve the needs of its existing shippers.

69. Nonetheless, El Paso agreed to construct this additional capacity and to forgo additional revenues from this capacity until its next rate case, *i.e*., until this proceeding. The Commission held El Paso to its agreement and stated that El Paso would forgo additional revenues from these projects until its next [this] rate case.[52] However, nothing in the Capacity Allocation orders suggests that El Paso should be unable to recover the costs of these projects from its customers in this rate case. Moreover, the Commission addressed the issue of cost recovery for the Power-Up Project in the certificate order authorizing its construction.[53] The certificate order holds that absent changed circumstances, El Paso may roll-in the costs of the Power-Up Project in its next [this] rate case.[54] Therefore, based on the Commission's prior orders, absent changed circumstances, the costs of these facilities should be rolled-in to El Paso's rates in this proceeding. Therefore, the rates of these facilities will be allocated to all of El Paso's customers, and concerns that the costs would be allocated only to the East of California

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[49] *El Paso Natural Gas Co*., 103 FERC ¶ 61,280 at P 41-45 (2002), *reh'g denied*, 105 FERC ¶ 61,202 at P 14 (2003).

[50] 104 FERC ¶ 61,045 at P 97.

[51] As the Commission stated in the Capacity Allocation Proceeding, the Commission does not have the authority under the NGA to order a pipeline to construct additional capacity. *Id.* at P 104 n.104.

[52] *Id.* at P 109.

[53] *El Paso Natural Gas Co*., 103 FERC ¶ 61,280 at P 41-45; 105 FERC ¶ 61,202 at P 14.

[54] 104 FERC ¶ 61,045 at P 149 & n.145.

customers is unfounded. The specific method of including the costs in the rates can be addressed at the hearing, but the Commission makes clear that Article 11.2(a) does not preclude inclusion of the costs of these expansions in all shippers' rates in this proceeding.

3. Limiting Rate Caps to Billing Determinants

70. As discussed above, the Commission has concluded that the Article 11.2(a) rate cap applies to existing contracts of eligible shippers. The parties have also raised issues concerning how the rate cap will apply to these contracts. As discussed below, the Commission finds that, under the terms of the Settlement, the Article 11.2(a) rate cap applies to all the service both the historical CD customers and the former FR shippers are receiving under their 1995 TSAs which uses the capacity in existence at the time of the 1996 Settlement. Thus, the rate cap will be applied to the CDs of the former FR shippers, minus the portion of those CDs that is provided by expansion capacity, and to the Settlement CDs of the historical firm CD shippers.

71. El Paso asserts in its prepared testimony that the Article 11.2(a) rate cap must be measured against the billing units that are "reasonably consistent with the billing units or quantities underlying the prior Settlement rates."[55] Thus, El Paso suggests that the Article 11.2(a) rate cap protection must be limited to the billing determinants in the 1996 Settlement. In designing the rates of the former FR shippers in its proposed alternate tariff sheets, El Paso applied the rate cap to the billing determinants by subtracting from the capacity allocated to each shipper in the Capacity Allocation Proceeding, the amount of that capacity that was attributable to expansion capacity, Block capacity, and turnback capacity. As a result, the billing determinants used by El Paso to calculate the rate cap are lower than the Settlement billing determinants, with the exception of five former FR shippers for whom El Paso used billing determinants that are higher than their Settlement billing determinants.

72. Texas Gas and Municipal Customers argue that El Paso's position is inconsistent with the language of Article 11.2(a) of the Settlement that the rate protection will apply to "service under such TSA." They argue that pursuant to this language, the rate cap should apply to the current CD of each of the former FR shippers. These parties assert that service under their TSAs was FR service, unlimited by any CD or billing determinant restriction, and that their CD service is a conversion of, not an addition to or increase of, their pre-existing FR service. In addition, Texas Gas states that billing determinants were not intended to limit or define the former FR shippers' use of the system.

73. Municipal Customers argue that their interpretation is further supported by a comparison of subparagraphs (a) and (b) of Article 11.2. Municipal Customers state that

[55] See Testimony of Palazzari, EPG Exh. No. 69 at 74.

there is no language in subparagraph (a) limiting application of the rate cap to capacity in existence at the time of the Settlement. In contrast, they state, subparagraph (b) specifically limits El Paso's obligations to capacity on the system on December 31, 1995. Municipal Customers assert that if the parties had intended to limit the application of Article 11.2(a) to then-existing capacity, they could have done so.

74. Commission Response**.** In determining the meaning of a settlement, the Commission applies the traditional rules of contract construction.[56] Pursuant to these rules, the Commission must ascertain the intent of the parties by considering the language of the document itself, its purpose, and the circumstances of its execution and performance.[57] Thus, the Commission looks to the language of the settlement and its regulatory context.[58] In the absence of an ambiguity, the Commission determines the meaning of the agreement from the language of that agreement without resort to extrinsic or parole evidence.[59] If extrinsic evidence is appropriate to show intent, that evidence must show the mutual intent of the parties at the time of the negotiations.[60]

75. Applying these principles here, the Commission first looks to the language of the Settlement. Article 11.2(a) provides in pertinent part:

> 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 [for inflation] …(emphasis added).

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[56] E.g., *Mid Louisiana Gas Co. v. FERC*, 780 F.2d 1238 at 1243 (5th Cir. 1986).

[57] *Pennzoil Co. v. FERC*, 645 F.2d 360, 388 (5th Cir. 1981), cert. denied, 454 U.S. 1142 (1981).

[58] *Amerada Hess Pipeline Corp*., 74 FERC 61,318 (1996), *aff'd*, *Amerada Hess Pipeline Corp. v. FERC*, 117 F.3d 596 (D.C.Cir. 1997); *Columbia Gas Transmission Corp*., 64 FERC 61,365 at 63,582 (1993) (citing *Pennzoil Co. v. FERC*, 645 F.2d 360, 368 (5th Cir. 1981), *cert. denied*, 454 U.S. 1142 (1981).

[59] *Seattle v. FERC*, 923 F.2d 713, 716 (9th Cir. 1991); *Alabama Power Co. v. FERC*, 993 F.2d 1557, 1565 (D.C.Cir. 1993).

[60] *E.g*., *Farmland Industries v. Grain Board of Iraq*, 904 F.2d 732, 738 (D.C. Cir. 1990). *See Amerada Hess Pipeline Corp*., 74 FERC ¶ 61,318 at 62,007 n.18 (1996).

Therefore, Article 11.2(a) specifies that the rate cap for continuing service under a 1995 TSA is the rate established in Article 3.2(a) of the Settlement, as adjusted for inflation.

76. We turn then to Article 3.2(a) of the Settlement, which provides:

> The base settlement rates, which shall be effective as of January 1, 1996, are set forth on the "Statement of Rates" tariff sheets included under the tab "Pro Forma Tariff Sheets," Tab 1, and incorporated herein by reference.

Thus, according to the terms of the Settlement, the "Statement of Rates" tariff sheets found behind Tab 1 set forth the rate cap. Pro Forma Tariff Sheets No. 22, 23, and 24 behind Tab No. 1 are labeled "Statement of Rates" and set forth the reservation and usage "rates per Dth" for FT-1 service during the term of the Settlement. Pro Forma Tariff Sheets No. 26 and 27 set forth the FT-2 rates in the same manner. The tariff sheets make no distinction between CD customers taking FT-1 service and FR customers taking the same service. Thus, the rate cap is the same "rate per Dth" for both CD and FR customers.

77. The key issue in determining how to apply that rate cap in the instant section 4 rate case is the nature of the "Dths" to which the rate cap should be applied. For CD customers, this issue is relatively easy to resolve. We have already held that the rate cap applies to the CD customers' continuing service under their 1995 TSAs. During the term of the 1996 Settlement, the historical CD shippers paid the per unit reservation rates in the relevant tariff sheets for each Dth of their contract demand under the 1995 TSAs. It follows that the Article 11.2(a) rate cap for the CD customers' reservation charges should similarly apply to each Dth of the contract demands in their 1995 TSAs. However, the rate cap does not apply to any additional capacity acquired by the CD customers under new contracts executed after 1995. Thus, the maximum rate applicable to service under those new contracts will be the just and reasonable rate determined in this proceeding.

78. This issue is more complicated for the FR customers. Because the FR customers did not have CDs at the time of the 1996 Settlement, that Settlement included agreed-upon billing determinants for each FR customer. Throughout the term of the Settlement, those customers paid the "per Dth" reservation charge in the relevant tariff sheets for each Dth of their billing determinants, instead of CDs.[61] However, in the Capacity Allocation Proceeding, the Commission converted the FR customers' contracts to CD

[61] Those billing determinants were set forth on Pro Forma Tariff Sheet Nos. 117 and 118 behind Tab No. 1. The tariff sheets containing the billing determinants are not labeled "Statement of Rates" and thus were not among the rate sheets referred to in Article 3.2 of the Settlement setting forth the rate cap.

contracts. As a result, most of the FR customers now have CDs in excess of their billing determinants in the 1996 Settlement.[62] In addition, El Paso provides a portion of this additional service using the new Line 2000 and Power Up capacity El Paso constructed after the 1996 Settlement. While El Paso had sufficient capacity at the time of the 1996 Settlement to provide FR customers some service in excess of their 1996 Settlement billing determinants, that capacity was insufficient to permit El Paso to provide the full amount of service reflected in the FR customers' allocated CDs.

79. In view of the language of the Settlement and its regulatory context, we find El Paso's proposal to apply the rate cap only to the FR customers' billing determinants in the 1996 Settlement to be unreasonable for several reasons. First, there is no language in the 1996 Settlement suggesting that the rate cap is tied solely to the FR customers' billing determinants under that Settlement. Article 11.2(a) provides for the rate cap to apply to "service under" TSAs in effect on December 31, 1995, without any reference to a particular set of billing determinants. In addition, Article 3.2(a) of the Settlement describes the rate cap as "the base settlement rates . . . set forth on the 'Statement of Rates' tariff sheets included under the tab 'Pro Forma Tariff Sheets,' Tab 1." Those "Statement of Rates" tariff sheets make no reference to the FR customers' Settlement billing determinants. Rather, the Settlement billing determinants were on other pro forma tariff sheets not referenced by Article 3.2(a). Thus, the provisions of the 1996 Settlement establishing the rate cap make no reference to the Settlement billing determinants.

80. Moreover, Article 9 of the 1996 Settlement provided that the Settlement billing determinants would remain in effect only for the term of the Settlement.[63] Therefore, the Settlement contemplated that the FR customers' billing determinants for service under their 1995 TSAs could change after the term of the 1996 Settlement to reflect changes in their use of the system. Given these facts, we believe that, if the parties to the Settlement had intended that the post-settlement rate cap apply only to the Settlement billing determinants, despite the fact those determinants were subject to change in the post-Settlement period for rate design and billing purposes, the parties would have crafted language more clearly providing for this result.

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[62] See El Paso's final Capacity Allocation Report which sets forth the new CDs of each shipper. No FR shipper received a CD less than its 1996 Settlement billing determinant.

[63] Article 9 of the Settlement provides:

Absent mutual agreement of El Paso and the shipper involved, the contract demand ("CD") and billing determinants on which the Settlement rates are based shall not be changed during the term of the Stipulation and Agreement except to the extent of a contract termination or step-down as described in Pro Forma Tariff Sheet No. 311, Section 25.1(a)(iii), attached hereto under Tab 4, or as provided in this Article IX.

81. On the other hand, the FR customers go too far in arguing that the rate cap must apply to the entire amount of their allocated CDs resulting from the Capacity Allocation Proceeding. The Commission finds that it is consistent with the language of the Settlement, its purpose, and its regulatory context to interpret the section 11.2(a) rate cap as being limited to service El Paso could provide the FR customers at the time of the 1996 Settlement with its system as it then existed. As the Commission held in the Capacity Allocation Proceeding,[64] neither El Paso's 1995 TSAs with its FR customers, nor the 1996 Settlement itself, obligated El Paso to build capacity at its own expense to meet the growing demands of the FR customers. Rather, the 1996 Settlement continued in effect a provision of an earlier 1990 settlement that El Paso need only expand its system to the extent "economically justified."[65] The Commission interpreted this to mean that El Paso need not expand its system to serve the increased demands of FR customers, unless they contribute sufficiently to the costs of the expansion "to make that expansion economically justified to El Paso."[66] Given this limit on El Paso's obligation to expand its system to serve the FR customers, the Article 11.2(a) rate cap does not extend to additional service provided by such future expansion projects.

82. This is particularly so, since the Article 11.2(a) rate cap equals the base rates agreed to in the 1996 Settlement for service during the term of the Settlement, adjusted for inflation. The parties negotiated those rates in light of the costs and revenues of El Paso's system as it existed at the time of the Settlement, when no new construction was planned. The rate cap accordingly contains no provision for recovery of the costs of constructing new capacity, which would likely be in excess of the depreciated existing capacity costs reflected in the rate cap. It would make little sense for the parties to negotiate a settlement which had the effect of (1) providing that El Paso need not expand its system to serve the increased needs of its FR customers unless the FR customers paid the costs of the expansion, while (2) simultaneously capping the FR customers' rates for service on such an expansion at a level below that necessary to make the expansion "economically justified to El Paso."

83. In addition, not extending Article 11.2(a) to additional service provided by expansions is consistent with the overall purpose of the 1996 Settlement. The 1996 Settlement was negotiated at a time when there was substantial excess capacity on El Paso's system, as it then existed. The California LDCs had notified El Paso that they would be turning back substantial amounts of their capacity, with the result that approximately 35 percent of El Paso's capacity would be unsubscribed. Therefore, the

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[64] 104 FERC ¶ 61,045 at P 103-104.

[65] Article 3.6 of 1990 Settlement, *El Paso Natural Gas Co*. 54 FERC ¶ 61,316 (1991), *order on reh'g*, 56 FERC ¶ 61,290 (1991).

[66] 104 FERC at P 103.

focus of the 1996 Settlement was a negotiated agreement between El Paso and its customers under which each agreed to absorb a share of the costs of the unsubscribed portion of the system as it then existed. The primary purpose of Article 11.2 was to ensure that El Paso would not seek, in a future rate case, to recover any of the existing capacity costs it had agreed to absorb. As several of the former FR shippers point out in their comments, El Paso's pledge in the Settlement not to seek recovery of stranded costs again from those shippers that shared the expense in 1996 was critical to the Settlement.[67] Capping the rates for new service provided by subsequent expansions is not necessary for this purpose.

84. The Commission thus finds that the rate cap does not apply to increased service the FR customers have obtained as a result of the post-1996 Settlement Power Up and Line 2000 expansions. This finding is consistent with the Commission's holding in the certificate proceeding for Line 2000 and the Power Up expansion that El Paso could recover the costs of its expansions in its next rate case. The Line 2000 and Power Up expansion capacity was not under contract to any shipper in 1995 and was not part of El Paso's service obligation to its shippers under the Settlement. To adopt the interpretation of Texas Gas and Municipal Customers would provide the FR shippers with capacity from the Line 2000 and Power Up Projects at no additional expense to them, contrary to the terms of the Settlement and the Commission's orders.

85. Consistent with the above discussion, the billing determinants of each FR customer subject to the rate cap should be determined at the hearing as follows. First, the parties should determine the amount of Line 2000 and Power Up expansion capacity allocated to each of the FR customers. That amount should then be subtracted from each FR customer's allocated CD resulting from the Capacity Allocation Proceeding. The Article 11.2(a) rate cap will apply to the resulting amount for each FR customer.[68] This calculation has the effect of giving each FR customer the benefit of the rate cap for all the service it receives using El Paso's 1995 capacity, including increased service above the level of the customer's 1996 billing determinants which did not require an expansion of the system. That is consistent with the fact that the full requirements clause in each FR customer's 1995 TSAs obligated El Paso to provide those customers any additional service not requiring an expansion. However, the FR customers will not receive the

[67] Initial Brief of the El Paso Municipal Customer Group Regarding Application of Article XI of the 1996 Settlement (October 5, 2005) at p.16-17; Joint initial Brief of the Arizona Electrics Regarding Application of Article XI of the 1996 Settlement (October 5, 2005) at p. 2; Initial Comments of Southwest Gas Corporation on the Applicability of the Article XI Rate Provisions (October 5, 2005) at pp. 5, 9-11.

[68] If this amount is less than an FR customer's 1996 Settlement billing determinants, then the rate cap should apply to the entire amount of that customer's 1996 Settlement billing determinants.

benefit of the rate cap for service they are receiving only as a result of the post-1996 Settlement expansions. That is consistent with the fact that the 1995 TSAs did not require El Paso to expand its system at its own expense.

86. Finally, we find that these limits on the rate cap maintain the 1996 Settlement's balance of equities between the CD and FR shippers. It applies the rate cap to the former FR shippers in a similar manner as it is applied to the historical CD shippers. To the extent that the historical CD shippers needed capacity above the level in their 1995 TSAs, they had to enter into new contracts for that additional capacity and pay the uncapped FT rate for that new capacity. It is just and reasonable and in the public interest and consistent with the Settlement that the former FR customers also pay the uncapped FT rate for the increased service their 1995 TSAs did not require El Paso to provide.

4. El Paso's Cost Recovery

87. El Paso argues that if the Commission determines that Article 11.2 continues to apply, El Paso has the right to reallocate costs it cannot recover from the Article 11.2-protected shippers to other shippers or to contracts that are not covered by Article 11.2. El Paso states that it did not agree in the 1996 Settlement to relinquish its right to a reasonable opportunity to recover its cost of service, including the right to reallocate costs to shippers and contracts not covered by Article 11.2. El Paso states that although protesting parties could try to demonstrate at a hearing that El Paso should not be allowed to recover such costs, they have provided no basis on which to summarily deny El Paso the right to recover these costs.

88. Further, El Paso states, it has the right to reallocate these costs as part of a discount adjustment. El Paso notes that some shippers argued that El Paso had not met the standard to permit a discount adjustment. However, El Paso states that at the time of the Settlement, it faced a massive capacity turnback that posed a unique competitive threat, and that it was in this environment that it agreed to the Settlement rates. El Paso states that the parties could challenge the basis for its discount adjustment at the hearing, but that the protesting parties would have the burden of producing evidence challenging the basis for El Paso's proposed discount adjustment.

89. Aera Energy, Arizona Electrics, SoCalEdison, Southwest Gas, Texas Gas, and the ACC argue that El Paso should be at risk for the Article 11.2 rates and should not be permitted to recover from other shippers the costs it cannot recover under Article 11.2. SoCalEdison states that, contrary to El Paso's assertion, El Paso did agree to relinquish its right to a reasonable opportunity to recover its costs to the extent that costs exceed the rates provided under the rate cap. SoCalEdison states that El Paso's other customers did not agree to absorb these costs, subsidize favored customers, and make the pipeline whole. Texas Gas states that the plain language of Article 11.2(b) states that "El Paso

assumes full cost responsibility for any and all existing and future step-downs or terminations and the associated CD/billing determinants related to the capacity described in this subparagraph (b)."

90. These parties further argue that, contrary to El Paso's suggestion, the Article 11.2 rates are not discounted rates. Arizona Electrics state that there is nothing in the Settlement language that characterized the rate cap as a discounted rate. Southwest Gas argues that the Article 11.2 rate cap is not a discount, but is a negotiated rate for which no discount adjustment is appropriate. Similarly, Aera Energy states the Article 11.2 rates are not discounted rates, but are recourse rates because they are the maximum rates under the settlement.

91. Moreover, these parties argue, even if the rates were considered discounted rates, El Paso is not entitled to a discount adjustment under the Commission's discount policy. Arizona Electrics state that the purpose of a discount is to provide a pipeline with the necessary flexibility to price capacity to attract new load or retain existing load that, absent the discount, the pipeline would not transport. Arizona Electrics state that there has been no showing that absent the rate cap, East of California shippers would purchase or transport their gas elsewhere. Similarly, Aera Energy asserts that the Article 11.2 rates were not necessary to meet competition, but were simply a settlement provision agreed to settle the case. Further, Aera Energy states, the rationale that discounts increase throughput and thereby benefit all shippers does not apply here.

92. Commission Response. The Commission finds that there is nothing in the Settlement that prevents El Paso from proposing to price its services so that it could recover its costs from other shippers to the extent that the Article 11.2 rates would not recover its cost of service. The provision in Article 11.2 (b) that "El Paso assumes full cost responsibility for any and all existing and future step-downs or terminations" is one of the bargains in the Settlement between the settling parties. The Commission does not read this provision as providing any guarantees to non-parties to the Settlement. The reasonableness of El Paso's rates will be addressed at the hearing, and El Paso will have the burden of establishing the justness and reasonableness of its rates, but the Settlement does not preclude El Paso from proposing rates that recover its cost of service.

93. Further, to the extent that El Paso proposes to include a discount adjustment in its rates, that proposal will be evaluated at the hearing pursuant to the Commission's selective discount policy.[69] Under that policy, the pipeline has the ultimate burden of showing that any discount for which it seeks an adjustment was necessary to meet

[69] *See Policy for Selective Discounting for Natural Gas Pipelines*, 111 FERC ¶ 61,173, *reh'g denied*, 113 FERC ¶ 61,173 (2005).

competition, and El Paso will bear this burden at the hearing.[70] As the Commission explained in its orders on its discount policy, once a party challenging the discount raises a reasonable question concerning whether the discount was granted to meet competition, the pipeline is required to show that the discount was granted to meet competition.[71]

5. Matters to be Addressed at the Hearing

94. As discussed above, the Commission has provided general guidelines concerning how the rate caps should be applied to the rates of the eligible shippers. The details of the application of these guidelines should be addressed by the parties at the hearing. The issues to be addressed at the hearing will include whether El Paso is entitled to a discount adjustment for any discounted rates, and how to calculate the rate for each shipper.

The Commission orders:

(A) The provisions of Article 11.2 of El Paso's 1996 Settlement apply to the rates of eligible shippers to the extent set forth in this order.

(B) El Paso is directed to refile, within 15 days of the issuance of this order, tariff sheets consistent with the discussion in this order.

By the Commission. Commissioner Kelly concurring with a separate statement attached.

(S E A L)

Magalie R. Salas,
Secretary.

[70] *See*, 111 FERC ¶ 61,173 at P 59-66.

[71] 113 FERC ¶ 61,173 at PP 104-105. The Commission does not routinely grant requests for discount adjustments, and the Commission has denied pipelines the adjustment where the pipelines have failed to meet their burden of showing that the discounts were required to meet competition. For example, in *Panhandle Eastern Pipe Line Co*, 74 FERC ¶ 61,109 at 61,401-02 (1996), *Williams Natural Gas Co*, 77 FERC ¶ 61,277 at 62,206-07 (1996), and *Trunkline Gas Co.*, 90 FERC ¶ 61,017 at 61,096 (2000), the Commission held that the pipelines had not met their burden to show that the discounts to their affiliates were required by competition. In addition, in *Iroquois Gas Transmission System*, 84 FERC ¶ 61,086 at 61,476-78 (1998), and *Trunkline Gas Co.*, 90 FERC ¶ 61,017 at 61,092-95 (2000), the Commission disallowed a discount adjustment with respect to discounts given to non-affiliates.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

El Paso Natural Gas Company Docket No. RP05-422-000

(Issued March 20, 2006)

KELLY, Commissioner, *concurring*:

As part of its rate case filing under NGA section 4, El Paso proposes to eliminate the rate-related provisions contained in Article 11 of its 1996 Settlement. El Paso and its maximum-rate shippers agreed upon these settlement rates in order to resolve the turnback capacity problem facing El Paso's system at that time, and generally waived their NGA section 4 and 5 filing rights under the settlement. Based on the facts presented in this case, I agree that the Commission should apply the public interest standard under *Mobile*[72] and *Sierra*[73] in reviewing El Paso's proposed modification to the 1996 Settlement at the hearing.

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Suedeen G. Kelly

[72] *United Gas Pipeline Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956).

[73] *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956).