

NO ORAL ARGUMENT YET SCHEDULED

**IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT**

No. 04-1226, *et al.*

**EXXON MOBIL CORPORATION, *et al.*
PETITIONERS,**

v.

**FEDERAL ENERGY REGULATORY COMMISSION,
RESPONDENT.**

**ON PETITION FOR REVIEW OF ORDERS OF THE
FEDERAL ENERGY REGULATORY COMMISSION**

**BRIEF FOR RESPONDENT
FEDERAL ENERGY REGULATORY COMMISSION**

STATEMENT OF THE ISSUE

Did the Commission reasonably conclude that the “Firm-to-Wellhead” proposal of Petitioner Transcontinental Gas Pipe Line Corporation (“Transco”) would impermissibly modify certain shippers’ transportation contracts by requiring the shippers to take and to pay for transportation service for which they had not contracted?

STATUTES AND REGULATIONS

The statutes and regulations applicable to this case are set forth in an addendum to this brief.

STATEMENT OF THE CASE

Transco, an interstate natural gas pipeline, and producers and marketers (“Indicated Shippers”)¹ that take service from Transco, seek review of two orders, *Transcontinental Gas Pipe Line Corp.*, 104 FERC ¶ 61,171 (2003) (JA 392-400), *reh’g denied*, 107 FERC ¶ 61,156 (2004) (JA 485-96).² These orders reject Transco’s “Firm-to-Wellhead” (“FTW”) proposal, which would replace the “IT-Feeder” priority for interruptible transportation (“IT”) service currently provided on Transco’s production-area supply laterals and the “firm” transportation (“FT”) service currently offered on Transco’s production-area mainline with a single FT service covering both the supply laterals and the mainline. The proposal, submitted in June 1993, would require certain shippers to replace their current production-area mainline FT service with a new, expanded service, and to pay a higher rate.

¹ All citations to the *FERC Reports* are captioned *Transcontinental Gas Pipe Line Corp.* unless otherwise noted.

² All citations to the *FERC Reports* are captioned *Transcontinental Gas Pipe Line Corp.* unless otherwise noted.

The case – despite its Byzantine history, technical subject matter and lengthy orders – is a simple one. In previous orders, the Commission decided that the FTW proposal would impermissibly modify existing FT contracts by forcing them to take and pay for a service for which they had not contracted. *Exxon Mobil Corp. v. FERC*, 315 F.3d 306, 311 (D.C. Cir. 2003), endorsed that reasoning, but, nonetheless, remanded to allow the Commission to reconcile the reasoning with statements in other orders – that addressed Transco’s “Firm Transportation Supply Lateral” (“FTSL”) proposal – that replacement of the IT-Feeder priority with FT service on the supply laterals automatically would provide mainline FT shippers rights to capacity on the supply laterals without modifying the shippers’ contracts.

There is no inconsistency between the FTW and FTSL orders because each set of orders address different FT rights. The FTW orders would not only eliminate the IT-Feeder priority on the supply laterals, but also would force the shippers to take “primary point rights” to supply-lateral capacity, *i.e.*, rights that could not be “bumped” or preempted, and for which the shippers would have to pay higher rates. As *Exxon Mobil* observed, this forced transfer of rights would require an impermissible modification of the shippers’ FT contracts. In contrast, the FTSL orders merely stated that the elimination of the IT-Feeder priority on the supply laterals would entitle FT shippers on the production-area mainline to “secondary point

rights” on the laterals, *i.e.*, rights that could be preempted by other shippers purchasing primary point rights on the laterals. The Commission has long held that pipelines may provide shippers secondary point rights without modifying their contracts.

Thus, while the FTSL orders found that Transco could provide its mainline FT shippers secondary point rights on the supply laterals without modifying the shippers’ contracts, the FTW proposal would force those shippers to take primary rights on the laterals, which would impermissibly revise the shippers’ contracts. Thus, FERC’s rejection of that proposal is perfectly consistent with the reasoning in the FTSL orders.

All that is left for the Court to consider is Petitioners’ argument that the public interest somehow requires the Commission to force these contract modifications on the shippers. As no public interest considerations justify – much less require – the contract modifications at issue, the orders should be affirmed in their entirety.

I. Statutory and Regulatory Framework

A. The Natural Gas Act

Section 4(a) of the Natural Gas Act (“NGA”), 15 U.S.C. § 717c(a), requires that “[a]ll rates and charges made” or “demanded . . . for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates and charges, shall be just

and reasonable[.]” To assure the effectuation of this requirement, each interstate pipeline must file and comply with tariffs showing all jurisdictional rates and all practices and regulations affecting those rates. 15 U.S.C. §§ 717c(c), 717c(d). Pipelines may propose changes in their tariffs under NGA § 4(e), 15 U.S.C. § 717c(e), but have the burden of showing that their proposed tariff revisions are “reasonable and fair.” *FPC v. Louisiana Power & Light Co.*, 406 U.S. 621, 645 (1971).

NGA § 5(a), 15 U.S.C. § 717d(a), states that when FERC finds an existing rate to be unjust or unreasonable, it must replace that rate with a just and reasonable rate. To effectuate such a replacement, the Commission (or a complainant seeking Commission action) must prove that the existing pipeline rate is unjust and unreasonable, and that the rate to be imposed on the pipeline is just and reasonable. *See, e.g., Consolidated Edison Co. v. FERC*, 165 F.3d 992, 1000-01 (D.C. Cir. 1999).

B. The *Mobile-Sierra* Doctrine

The NGA regulatory regime is superimposed on a private contractual regime. *See generally Boston Edison Co. v. FERC*, 233 F.3d 60, 64-65 (1st Cir. 2000). The so-called *Mobile-Sierra* doctrine, based on *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956) (“*Mobile*”), and *FPC v. Sierra Power Co.*, 350 U.S. 348 (1956), prohibits pipelines from unilaterally proposing rate changes that are not authorized by the pipeline’s contracts with its customers.

There are exceptions to this prohibition. A regulated utility may make unilateral tariff changes by including a contractual clause reserving such rights. *United Gas Pipe Line Co. v. Memphis Light, Gas & Water Div.*, 358 U.S. 103 (1958). A “*Memphis*” clause authorizes the pipeline to make unilateral NGA § 4(e) filings to change the rates, terms, and conditions under which the pipeline will provide the service included in the customer's contract. *Exxon Mobil*, 315 F.3d at 310. In addition, NGA § 5(a) requires the Commission to revise contracts if it finds their existing rates, terms, or conditions to be contrary to the public interest. *See Mobile*, 350 U.S. at 344-45.

C. Impact of Order No. 636 on Firm Transportation Services

Order 636³ restructured the natural gas pipeline industry to maximize the benefits flowing from Congressional decontrol of natural gas pricing at the wellhead. *See generally UDC, supra* n.3, 88 F.3d at 1123-27. In furtherance of this end, the

³ *Pipeline Serv. Obligations & Revisions to Regulations Governing Self-Implementing Transp.; and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, Order No. 636, FERC Stats. & Regs., Regs. Pmbles. 1991-96 & 30,939, *order on reh'g*, Order No. 636-A, FERC Stats. & Regs., Regs. Pmbles. 1991-96 & 30,950, *order on reh'g*, Order No. 636-B, 61 FERC & 61,272 (1992), *reh'g denied*, 62 FERC & 61,007 (1993), *aff'd in relevant part, United Distribution Cos. v. FERC*, 88 F.3d 1105 (D.C. Cir. 1996) (“*UDC*”).

Commission directed pipelines to: (1) “unbundle” their sales and transportation services and thus enable customers to take only such services as they required; and (2) transport other sellers’ gas on the same terms that they transported their own sales gas. *See* Order No. 636 at 30,412-13.

Order 636’s requirement that pipelines unbundle their firm gas sales services, included a provision that their customers be allowed to convert their entitlements to bundled sales from the pipeline into rights to an equivalent amount of FT capacity on the pipeline. That allowed customers to purchase gas from sources other than the pipeline by using their FT capacity to transport the gas to their receipt points. *UDC*, 88 F.3d at 1130-33.

FT service is not “subject to a prior claim by another customer[.]” 18 C.F.R. § 284.7(a)(3). Pipelines are permitted to charge a two-part rate for FT: (1) a “reservation charge,” which is a fixed monthly charge that the customer pays regardless of whether it uses its capacity; and (2) a “volumetric” charge for each unit of gas actually transported for the shipper. *See* 18 C.F.R. § 284.7(e). FT service contrasts with IT service, which is subject to a prior claim by another customer (*i.e.*, is subject to interruption), and for which pipelines may charge only a one-part, volumetric charge. *See* 18 C.F.R. §§ 284.9(a)(3), 284.9(c).

1. Flexible Point Policy

a. Primary and Secondary Point Rights

Contracts for FT service “typically provide that the pipeline will transport up to a specified contract demand from a primary receipt point or points listed in the contract to specified primary delivery points also listed in the contract.” 104 FERC ¶ 61,171 P 24 (JA 396). Because these “primary point rights” are guaranteed, “the pipeline must reserve sufficient capacity at the primary points and the intervening mainline” to offer this service. *Id.*

Order No. 636 required that FT shippers be permitted to use all other points in the zones for which they pay reservation charges “on an interruptible basis without losing their priority for firm service.” Order No. 636 at 30,429. FT shippers rights to these other receipt and delivery points are referred to as “secondary point rights.” *See* 107 FERC ¶ 61,156 P 36 (JA 491). FT shippers’ secondary point rights are inferior to the rights of FT shippers using those points as primary delivery points, but are superior to IT shippers’ rights to those points. Order No. 636-A at 30,583.

It is important to note that the pipeline does not need to reserve capacity to provide FT shippers service at secondary points as it must to serve them at primary points. 104 FERC ¶ 61,171 P 25 (JA 396). Accordingly, no additional reservation

charge is paid for secondary point rights; put another way, the reservation charge paid for primary point rights on a segment of the pipeline also pays for secondary rights on that segment. *See* Order No. 636-A at 30,585 (a pipeline must give an FT shipper “flexibility in receipt and delivery points for the part of the system for which it pays a reservation charge”). Similarly, a shipper’s rights to secondary points do not preclude the pipeline from selling primary point rights to that capacity to another shipper. *See Process Gas Consumers Group v. FERC*, 292 F.3d 831, 840 (D.C. Cir. 2002) (recognizing that pipeline had no obligation to give existing FT shippers a preference in competitive bidding for contested primary points).

b. Impact of Point Changes on Transportation Contracts

FERC requires pipelines to allow FT shippers “to change their primary points, as long as there is sufficient unsubscribed capacity available that the pipeline can guarantee firm service at the new point and the change does not reduce the reservation charges due to the pipeline.” 104 FERC ¶ 61,171 P 25 (JA 396). However, “an existing shipper's change from one primary point to some other point requires a change in its contract with” the pipeline. *Tennessee Gas Pipeline Co.*, 94 FERC ¶ 61,097 at 61,402 (2001).

In contrast, secondary point rights are conferred automatically upon an FT shipper without changing its contract. *Regulation of Short-term Natural Gas Transp.*

Servs., 101 FERC ¶ 61,127 at 61,527-9 (2002) (“*Short-term Service Regulation*”). FT contracts “include a provision incorporating the terms and conditions in the pipeline's tariff into the service agreement, thereby automatically giving the shippers any increased rights arising from changes in the terms and conditions.” 104 FERC ¶ 61,171 P 25 (JA 396). As a result, FERC implements its secondary point policy simply by acting under NGA § 5(a) to require pipelines to modify their tariffs “to provide firm shippers the right to use secondary points throughout the zones for which they pay.” *Id.* Such actions do not “improperly modify the shippers' individual service agreements.” *Short-term Service Regulation*, 101 FERC at 61,528.

2. Rate Design

In practice, the Commission sets a pipeline's rates by dividing its cost of service, expressed in dollars, by the projected demand of its customers, expressed in volumetric units of gas. *See, e.g., Williston Basin Interstate Pipeline Co. v. FERC*, 165 F.3d 54, 56 (D.C. Cir. 1999). Stated another way, the Commission calculates the rate for each unit of service by dividing costs by projected throughput or contract demand.

Order 636 mandated that pipelines utilize a “straight-fixed-variable,” or “SFV,” rate design for FT, under which fixed costs – costs incurred regardless of throughput – are recovered entirely through the reservation charge. *See* Order 636-A at 30,596.

Variable costs – costs incurred as a result of throughput – are recovered entirely through the FT volumetric or “usage” charge. This rate design contrasts with the “modified fixed variable” or “MFV” rate design, which allows pipelines to recover a portion of their fixed costs through the volumetric charge.

Once the per-unit “reservation rate” for a zone is calculated, an individual FT shipper’s monthly reservation charge is calculated by multiplying that rate by the amount of capacity the shipper reserves in the zone. For example, if the reservation rate for a zone is \$5.00/Mcf, and the shipper reserves 30,000 Mcf in that zone, the shipper’s monthly reservation charge is \$150,000.

II. Restrictions Imposed by Transco’s Unbundling Settlements on Supply-Lateral Service

Transco's mainline extends from production areas in the Gulf of Mexico, northeastward along the Atlantic seaboard, to an end point in the New York City metropolitan area. The system, which serves many of the major cities in the eastern United States, is divided into two general parts: an upstream production area around the Gulf coast that is subdivided into three zones (numbered 1, 2 and 3), and a downstream market area also consisting of three larger zones (4, 5 and 6) that begins at the Louisiana-Mississippi border and extends in a northeasterly direction to its terminus at New York City. Transco's production-area facilities include a mainline

system and supply laterals that extend from the mainline to gathering systems. *See* 95 FERC ¶ 61,322 at 62,129 (JA 250), *order on reh'g*, 96 FERC ¶ 61,142 (2001) (JA 265-69) (schematic showing Transco's system).

In anticipation of Order No. 636, Transco filed, and FERC approved, settlements ("1991 Settlements") implementing unbundling of Transco's services.⁴ The rights of Transco's former firm sales customers were converted from the right to receive bundled sales service to the right to receive unbundled FT on Transco's mainline.

A. Availability of Firm Transportation Service

The 1991 Settlements provided that, henceforth, Transco would only offer IT service on the production-area supply laterals. The settlements also established a priority, called the "IT-Feeder priority," for supply-lateral IT used to transport gas for ultimate delivery at the mainline to customers that had converted from firm sales to FT ("FT-conversion shippers"). 95 FERC at 62,129 (JA 250).⁵ The IT-Feeder priority

⁴ 55 FERC ¶ 61,446, *order on reh'g*, 57 FERC ¶ 61,345 (1991), *order on reh'g*, 59 FERC ¶ 61,279 (1992), *aff'd in relevant part sub nom. Elizabethtown Gas Co. v. FERC*, 10 F.3d 866 (D.C. Cir. 1993).

⁵ Though the IT-Feeder priority is "not a service . . . but merely a higher priority" that is "accorded to any shipper using IT service to provide gas to a firm shipper[.]" 107 FERC ¶ 61,156 P 24 (JA 489), the priority is sometimes referred to herein as "IT-Feeder service" for convenience.

was the highest on the laterals, except for FT service provided under pre-settlement contracts that were “grandfathered” under the settlements. *See* 55 FERC at 62,345-46, 62,377.

Though permitted to purchase IT-Feeder capacity, the FT-conversion shippers were neither assigned a share of nor obligated to purchase such capacity. 95 FERC at 62,136 & n.33 (JA 257). As events have unfolded, FT-conversion shippers have not purchased IT-Feeder service; rather, producers and marketers have purchased the service for the purpose of shipping gas to the FT-conversion shippers at the production-area mainline. *See* 107 FERC ¶ 61,156 P 3 (JA 485).

B. Availability of Secondary Point Rights

Consistent with Order No. 636’s flexible point policy, each FT-conversion shipper was given secondary point rights on the production-area mainline in the zones for which the shipper paid a reservation charge. However, “as long as the IT-Feeder service was in effect, the Commission found that Transco’s FT shippers should not have secondary point rights on the laterals,” even though they paid reservation charges for the zones. 104 FERC ¶ 61,171 P 34 (JA 491).

Denying FT-conversion shippers secondary point rights to the supply laterals departed from the Commission’s usual implementation of Order No. 636’s flexible

point policy. Because the FT-conversion shippers paid “reservation charges for service in the production area rate zones and those zones include[d] the supply laterals, ordinarily those shippers would be considered to be paying rates that include the cost of the supply laterals” and would, therefore, “be entitled to secondary point rights on the supply laterals as part of the terms and conditions of service in the tariff, without any change in their contracts.” 104 FERC ¶ 61,171 P 34 (JA 491).

Here, however, the departure was justified, because the FT shippers do “not pay rates for the laterals.” 104 FERC ¶ 61,171 P 35 (JA 491). Transco allocates its system-wide fixed costs to each of its rate zones and then calculates rates for each zone by dividing those costs by the “contract demand” (the amount of capacity Transco is obligated to supply) in each zone. *Id.* In determining a zonal FT reservation rate, Transco not only includes the contract demand stated in the FT contracts, but also imputes an additional contract demand projected for IT service, which includes the IT-Feeder volumes. *Id.* Thus, the greater the contract demand projected for IT, the lower the FT reservation rate for the zone. Because shippers currently “must contract for IT-Feeder service to move gas from the gathering systems to the production area mainline,” Transco’s rates “reflect significant imputed contract demand for the IT-Feeder service,” which, in turn, reduces the “rates paid by the FT-conversion shippers in each zone.” *Id.* P 36 (JA 491). The Commission found that the

imputed IT-Feeder volumes reduce the FT shippers' reservation rates to such an extent that, "in effect," FT shippers are "not paying for the laterals." *Id.*

III. Initial Proceedings Arising out of Transco's FTW Proposal

Under the FTW proposal, Transco would modify its Rate Schedule FT to require its FT-conversion shippers' to take FT on the supply laterals, and to remove the IT-Feeder priority from its IT Rate Schedule. *See* FERC Docket No. RP93-136, Second Revised Sheet No. 171 (June 4, 1993) (JA 176C). The proposed FTW service would give the FT-conversion shippers the highest priority available to supply-lateral receipt and delivery points, subordinate only to the rights of the grandfathered FT shippers. 104 FERC ¶ 61,171 P 8 (JA 393). To the extent the FT-conversion shippers' requests for capacity on production-area laterals exceeded available capacity, Transco would implement a *pro rata* allocation of available capacity determined in proportion to each capacity the shipper scheduled. *See generally* FERC Docket No. RP93-136, Original Sheet No. 164A (June 4, 1993) (JA 176B).

The FTW proposal would replace the one-part IT-Feeder rate on the supply laterals and the two-part FT rate on the production-area mainline with a single, two-part rate, applicable to both supply laterals and mainline, for each production-area zone. *See* 95 FERC at 62,136 (JA 257). Transco would allocate the supply laterals' fixed costs to these new FT rates. *See id.* at 62,137 (JA 258). As a result, the proposal

would increase the FT-conversion shippers' reservation charges. *See* 107 FERC ¶ 61,156 P 41 (JA 492) (FT-conversion shippers “would have to pay higher rates under the proposal”).

Opinion No. 405 rejected Transco's proposal on the ground that it compelled the FT-conversion shippers to purchase a new service. 76 FERC ¶ 61,021 (JA 132-59), *order on reh'g*, 77 FERC ¶ 61,270 (1996) (JA 160-72). However, in *Exxon Corp. v. FERC*, 206 F.2d 47 (D.C. Cir. 2000), this Court remanded. The Court pointed out that the FT-conversion shippers' contracts contained *Memphis* clauses that permit Transco to make NGA § 4(e) filings to modify the rates, terms, and conditions of its FT service, and found that the Commission had not explained why the *Memphis* clauses did not permit Transco to impose unilaterally its FTW proposal on the FT-conversion shippers. *Id.* at 52.

On remand – and after further review of the record – the Commission explained that the FT-conversion shippers had not contracted for service on the supply laterals, but instead had contracted only to take and pay for FT service on the production area mainline. 95 FERC at 62,138-139 (JA 259-60). Because Transco's FTW proposal would provide FT-conversion customers rights to supply-lateral points and require the customers to pay for these new rights in the form of a higher reservation charge, the proposal would require the customers to take and pay for service for which they had

not contracted and was outside the scope of the shippers' *Memphis* clauses. *See* 104 FERC ¶ 61,171 P 18 (JA 395).

Petitioners again appealed. As events developed, the outcome of that appeal would be substantially impacted by the Commission's rejection of a separate Transco supply-lateral proposal, discussed below.

IV. Transco's FTSL Proposal

While appealing Opinion No. 405, Transco made another NGA § 4(e) filing in FERC Docket No. RP98-381 to implement new FT service on the supply laterals. This time, instead of proposing to revise its existing FT rate schedule to provide FT service on the laterals, Transco proposed its FTSL rate schedule. As in the FTW proposal, Transco proposed to eliminate its IT-Feeder priority. In each production-area zone, Transco would provide service under the FTSL rate schedule on the supply laterals and under the FT rate schedule on the mainline. Subscribers to each service would pay the same zonal reservation rate.⁶ However, FTSL subscribers would not receive secondary point rights on the production-area mainline, and FT subscribers would not receive would not receive secondary rights on the supply laterals.

⁶ Shippers reserving both supply-lateral and mainline capacity in the same zone would pay a single reservation charge for that zone. *See* 86 FERC ¶ 61,175 at 61,611, *reh'g denied*, 88 FERC ¶ 61,135 (1999) (Transco would charge the mainline FT rate for use of the supply laterals).

The Commission rejected Transco's FTSL proposal as unjust and unreasonable, in part, because it would deny both FT and FTSL shippers the right to use flexible receipt and delivery points throughout each entire rate zone for which they would be paying a reservation charge. 84 FERC ¶ 61,337, *order on reh'g*, 85 FERC ¶ 61,357 (1998); 86 FERC ¶ 61,175, *supra* n.5. Transco's proposal to require both the FT and FTSL shippers to pay for FT throughout a zone, without allowing them secondary rights to all points within that zone violated Order No. 636's flexible point policy, which provides FT shippers the right to use secondary points throughout the zones for which they pay a reservation charge.

Transco contended that the FTSL proposal's restrictions on secondary point rights were consistent with the Commission's previous ruling that FT-conversion shippers were not entitled to secondary point rights on the supply laterals. 86 FERC at 61,609. In response, FERC explained that "while the IT-Feeder service was in effect, the Commission made an exception to its general receipt and delivery point policy, because the IT-Feeder service itself provided shippers with the flexibility to access receipt and delivery points throughout the production area." *Id.* However, because the FTSL proposal sought "to discontinue the IT-Feeder service, with its flexibility, and replace it with a firm service," there was "no longer any basis for permitting Transco to deny shippers the receipt and delivery point flexibility attendant to firm

service.” *Id.* As the FTSL proposal contemplated both FTSL and FT shippers paying the same reservation charge for the entire production-area zone in which each class of shipper reserved capacity, FERC’s flexible point policy dictated that both groups of FT shippers be given secondary point rights throughout the zone. *Id.*

V. The Second FTW Remand

Exxon Mobil reviewed the Commission’s second rejection of Transco’s proposed FTW service, discussed *supra* at 16. This time, the Court reasoned that but for an apparent inconsistency with the FTSL orders, FERC’s conclusion that the FTW proposal “would force conversion shippers to accept and pay for capacity in excess of their current obligations and that such a change exceeds the scope of the *Memphis* clauses appear[ed] perfectly reasonable.” *Id.* at 310.

Despite that ruling, the Court saw “a serious glitch” between the reasoning in the orders under review and the reasoning in the FTSL orders. 315 F.3d at 310. As the Court saw it, the FTW orders’ principal conclusion – that Transco’s proposal would modify the FT-conversion shippers’ contracts by forcing them to take and pay for service that they had not chosen to purchase – was based on the finding that those shippers currently had no rights on the supply laterals, would have to execute separate contracts to acquire such rights, and had not chosen to do so. 315 F.3d at 310 (citing 73 FERC ¶ 61,361 at 62,128 (1995)). However, the FTSL orders had stated that

Transco's elimination of its IT-Feeder priority would automatically grant such shippers secondary rights to the supply laterals in the zones for which the shippers paid a reservation charge – “apparently without modifying their service contracts[.]” *Id.* (citing 86 FERC at 61,609). The orders further indicated that “any cost allocation problems could be fixed by adjusting [the FT-conversion shippers’] zone reservation charges in a separate filing[.]” *Id.*

Petitioners argued that under the logic of the FTSL orders, (1) the FTW proposal's elimination of the IT-Feeder priority gave FT-conversion customers secondary rights to the supply laterals and (2) Transco was “entitled to adjust the reservation charges accordingly.” 315 F.3d at 311. The Court remanded the case to permit FERC to address these contentions. *Id.*

VI. The Challenged Orders

In the first challenged order, the Commission again rejected Transco's FTW proposal, explaining that it would not merely confer secondary point rights to the supply laterals – which would not require contract modifications – but, instead, would confer primary rights to those laterals – which would require modifications beyond what Transco could effectuate under a *Memphis* clause. 104 FERC ¶ 61,171 PP 27-28, 40-41 (JA 397, 399). Accordingly, there was no inconsistency between the orders' rejection of the FTW proposal and the statements regarding secondary point

rights in the FTSL orders. *Id.* PP 42-48 (JA 399-400). In the second challenged order, the Commission denied rehearing. 107 FERC ¶ 61,156.

These petitions followed.

SUMMARY OF ARGUMENT

Exxon Mobil endorsed the Commission's conclusion that the FTW proposal to eliminate the IT-Feeder priority and require the FT-conversion shippers to take FT service on the supply laterals modified their contracts beyond what was allowed under their *Memphis* clauses, but remanded orders rejecting the proposal to allow FERC to reconcile that conclusion with statements in the FTSL orders that under FERC's flexible point policy, elimination of Transco's IT-Feeder priority would provide such shippers rights to supply-lateral capacity automatically and without modifying their contracts. The Commission has fully reconciled those two conclusions.

There is no inconsistency because the FTW proposal would require the FT-conversion shippers to take primary point rights to FT capacity on Transco's supply laterals, whereas the mere elimination of the IT-Feeder priority on the laterals, discussed in the FTSL orders, would only provide these shippers secondary point rights. While the transfer of primary point rights requires a modification of an FT contract beyond what is permitted in a *Memphis* clause, the conferring of secondary point rights does not require a contract modification.

The rights at issue are primary point rights, rather than secondary point rights, for three related reasons. Secondary point rights to the supply laterals could be preempted by shippers that acquired primary point rights; the rights to supply-lateral

capacity conveyed under the FTW proposal cannot be so preempted. Similarly, if the FT-conversion shippers were receiving only secondary point rights to the supply laterals, other shippers could acquire primary point rights to the laterals and thereby share the laterals' costs; because the rights conveyed under the FTW proposal are of the highest priority, other shippers cannot acquire supply-lateral capacity, which assures that all supply-lateral costs will shift to the FT-conversion shippers. Finally, the conferring of secondary rights does not, by itself, justify an increase in an FT shipper's rates; the FTW proposal, however, would impose such an increase.

Petitioners make a number of arguments in a vain attempt to show that the FTW proposal is a mere change in rate design permitted by the *Memphis* clauses in the FT-conversion shippers' contracts, and that, in any event, the proposal does nothing more than give those shippers secondary point rights to the laterals and thus does not modify their contracts. None of these arguments can overcome the salient elements of Transco's proposal – the priority of capacity rights that would be conferred, and the imposition of a rate increase to reflect the resulting cost-shift. Petitioners' argument that any contract modifications resulting from implementation of the FTW proposal would be permissible under NGA § 5(a) as in the public interest also fails, because the public interest is not served by requiring shippers to take and to pay for a service for which they have not contracted.

ARGUMENT

I. STANDARD OF REVIEW

“The role of judicial review is only to ascertain” if the agency “has met the minimum standards set forth in the statute.” *U.S. Postal Serv. v. Gregory*, 534 U.S. 1 (2001). A court reviews FERC orders under the “arbitrary and capricious” standard set out in the Administrative Procedure Act at 5 U.S.C. § 706(2)(A). *Sithe/Independence Power Partners v. FERC*, 165 F.3d 944, 948 (D.C. Cir. 1999). To satisfy that standard, the Commission must “demonstrate that it has made a reasonable decision based on substantial evidence in the record and the path of its reasoning must be clear.” *Id.* (citations and internal quotations omitted).

Where the orders under review involve ratemaking “and thus an agency decision involving complex industry analyses and difficult policy choices, the court will be particularly deferential to the Commission’s expertise.” *Association of Oil Pipe Lines v. FERC*, 83 F.3d 1424, 1431 (D.C. Cir. 1996); *see also, e.g., Entergy Servs., Inc. v. FERC*, 319 F.3d 536, 541 (D.C. Cir. 2003) (explaining same “highly deferential” standard for issues of rate design); *Northern States Power Co. v. FERC*, 30 F.3d 177, 180 (D.C. Cir. 1994) (same).

II. THE COMMISSION PROPERLY REJECTED TRANSCO'S FTW PROPOSAL.

Exxon Mobil ruled that, but-for an apparent inconsistency with the FTSL orders, FERC properly concluded that Transco's FTW proposal would impermissibly modify the FT-conversion shippers' contracts by forcing those shippers to take and to pay for a service for which they had not contracted. 315 F.3d at 310. The Court remanded to allow the Commission to reconcile, if it could, that single apparent inconsistency – between (1) rejection of the FTW proposal, which would eliminate the IT-Feeder priority, on the ground that the proposal would require FT-conversion shippers to take and to pay for supply-lateral capacity for which they had not contracted, and (2) rejection of the FTSL proposal, which would have also eliminated the IT-Feeder priority, on the ground that the proposal failed to recognize FT-conversion shippers' secondary point rights to that same supply-lateral capacity. The challenged orders demonstrate that no inconsistency exists.

The Commission reasoned that to find that the FTW proposal “would not modify the FT conversion shippers' contracts” under the flexible point policy, FERC “would have to find that the proposal only entails giving the FT-conversion shippers secondary point rights on the supply laterals.” 104 FERC ¶ 61,171 P 26 (JA 397). Whereas providing FT shippers “secondary point rights does not change their

contracts[,]” providing such shippers “primary rights on the supply laterals . . . would constitute an impermissible, unilateral contract change.” *Id.*

The Commission based its finding “that Transco’s FTW proposal would give the FT-conversion shippers primary point rights on the supply laterals, not just secondary point rights[,]” 104 FERC ¶ 61,171 P 27 (JA 397), on three related grounds.

First, the “proposal entailed giving the FT-conversion shippers the highest possible priority for service on the supply laterals such that Transco would have had no additional firm capacity on the laterals to sell to other shippers as primary capacity.” *Id.* P 28 (JA 397). “In contrast, had the rights obtained by the FT customers been considered only secondary rights, Transco would have had lateral capacity to sell to new shippers as primary rights, with the highest priority.” *Id.* See also *Process Gas*, 292 F.3d at 840 (pipelines have no obligation to give existing FT shippers a preference in competitive bidding for contested primary points).

Second, the supply-lateral rights that Transco’s proposal would require the FT-conversion shippers to take could “have a significantly different effect” on those shippers’ rates than would be the case if the rights were merely secondary. 104 FERC ¶ 61,171 P 38 (JA 398). The “elimination of the IT-Feeder service would reduce the volumes used to design the FT rates” because “the rate design volumes would no longer include any imputed contract demand associated with IT-Feeder service.” *Id.*

(JA 399). Unless new shippers emerged on the supply laterals to create new contract demand, reducing this imputed contract demand would inevitably increase the FT-conversion shippers' rates for service in the production area. *Id.* However, Transco's FTW proposal would have *precluded* the sale of primary FT capacity to such shippers on the laterals, and, thus, forced the FT-conversion customers "to absorb the full increase in rates." *Id.* In contrast, a proposal that "the FT shippers be accorded normal secondary rights" would have allowed Transco to sell primary rights to FT capacity on the laterals, and such sales would have reduced the FT rate impact of eliminating the IT-Feeder priority. *Id.* P 39 (JA 399). Indeed, Opinion No. 405 "required that Transco have an open season to determine whether other shippers would be interested in obtaining firm capacity on the supply laterals." *Id.* (citing 76 FERC at 61,062 (JA 143)).

Finally, the FTW proposal itself would increase the FT-conversion shippers' rates. The FTW proposal would replace the one-part IT-Feeder rate on the supply laterals and the two-part FT rate on the production-area mainline with a single, two-part rate, applicable to the supply laterals and the mainline, for each production-area zone, *see* 95 FERC at 62,136 (JA 257). Because Transco would allocate the supply laterals' fixed costs to these new FT rates, *see id.* at 62,137 (JA 258), the FT-conversion shippers "would have to pay higher rates under the proposal." *See* 107

FERC ¶ 61,156 P 41 (JA 492). In that circumstance, treating the rights conferred as secondary point rights would be “inconsistent with Commission policy” treating “secondary firm service as an adjunct to a primary firm service for which the shipper has already contracted and paid.” *Id.* See also Order No. 636-A at 30,585 (a pipeline must give an FT shipper “flexibility in receipt and delivery points for the part of the system for which it pays a reservation charge”).⁷

Accordingly, “Transco's FTW proposal went beyond merely providing secondary rights on the laterals” in that it would have provided those shippers “with the highest priority of service on the laterals,” thus requiring the shippers “to fully absorb all the costs occasioned by the elimination of the IT-Feeder service, without the possibility of having those costs reduced by the sale of additional firm service in the zone.” 104 FERC ¶ 61,171 P 40 (JA 399). Thus, the “proposal would require the FT-conversion shippers to take primary firm service on the supply laterals for which they have not contracted,” and thereby “would modify their contracts in a manner not

⁷ To be sure, Transco’s elimination of the IT-Feeder priority, and the FT-conversion shippers’ consequent entitlement to secondary point rights to the supply laterals might also result in the supply laterals’ costs shifting to those customers. However, that would only be known after Transco conducted an open season to ascertain interest in the capacity. See 76 FERC at 61,062 (JA 143) (requiring Transco to conduct an open season). Until that event occurred, Transco would have no basis to propose an FT rate increase based on projected cost shifts.

authorized by their *Memphis* clauses.” *Id.* P 41 (JA 399). It followed that Transco had not met its NGA § 4(e) burden to show that the FTW proposal was just and reasonable, and that Transco’s shippers had not satisfied their burden under NGA § 5(a) to justify imposition of the proposal. *Id.*

The analysis in the FTSL orders was “fully consistent with the above analysis.” 104 FERC ¶ 61,171 P 42 (JA 399). Though the FTSL proposal, like the FTW proposal, would have eliminated the IT-Feeder priority, the FTSL proposal would have also instituted an FT service on the laterals that was separate from the mainline FT service. Though both the FTSL shippers and the FT-conversion shippers would have both paid a reservation charge based on the costs of each production-area zone in which they reserved capacity, the FTSL shippers would not receive “secondary firm rights on the production area mainline in the zone for which they paid,” and “the FT shippers, including the FT-conversion shippers,” would not receive “secondary firm rights on the supply laterals in the zones for which they paid.” *Id.* The Commission rejected the proposal because it violated the flexible point policy by depriving the FTSL and mainline FT shippers of secondary point rights in zones where they paid a reservation charge. *Id.*

FERC properly rejected the FTSL proposal because it denied the FT-conversion shippers secondary rights on the supply laterals, and properly rejected the FTW

proposal because it forced the shippers to take primary rights to those laterals. FERC “recognized that the FTW proposal’s elimination of the IT-Feeder service[,]” like the FTSL proposal’s elimination of that service, “would justify giving the FT-conversion shippers *secondary* firm point rights on the supply laterals[.]” 104 FERC ¶ 61,171 P 45 (JA 400) (emphasis in original). “However, the FTW proposal did not seek just to give the FT-conversion customers secondary firm rights on the supply laterals[,]” but rather, sought to require those shippers to take and pay for “*primary* firm rights,” which this Court had “recognized exceeded the *Memphis* clause.” *Id.* (emphasis in original). *See Exxon Mobil*, 315 F.3d at 310. For that reason, the Commission “rejected the FTW proposal as an improper modification of the FT-conversion shippers’ contracts.” 104 FERC ¶ 61,171 P 45 (JA 400).⁸ Thus, there was “no inconsistency” between the Commission’s rejections of the FTW proposal, which would have required FT-conversion shippers to take primary rights on the supply

⁸ The FTSL orders had “used this very distinction” to explain why “rejection of the FTSL proposal for failure to provide secondary point rights to the FT-conversion customers was not inconsistent with” rejection of the FTW proposal in Opinion No. 405. 104 FERC ¶ 61,171 P 46 (JA 400). The orders had explained that the FTW proposal would have required FT-conversion shippers “to pay for and receive *primary* rights on the production area laterals[,]” whereas providing flexible point rights to such shippers would give them “only *secondary* point access[,]” and thus “a lower priority than shippers” who subscribed “to FTSL firm service[.]” *Id.* (quoting 86 FERC at 61,610 n.17 (emphasis in FTSL order)).

laterals, and of the FTSL proposal, which would have denied those shippers secondary rights on the same laterals; rather, the Commission applied “the same policies” to two “very different proposals[.]” *Id.* P 47 (JA 400).

In response to Petitioners’ attempt to justify the FTW proposal as a vehicle for furthering the Commission’s policy favoring SFV rate design, the Commission reasoned that if Transco's goal were “to find an acceptable SFV rate design for service on the supply laterals,” the pipeline could effectuate that result without “requiring FT-conversion customers to take primary firm service on the supply laterals[.]” 107 FERC ¶ 61,156 P 51 (JA 494). For example, Transco was free under its *Memphis* clauses “to eliminate the IT-Feeder priority, and to offer firm capacity on the supply laterals” by filing “to establish the lateral capacity as a new zone with its own firm and interruptible rates, which all shippers could choose.” *Id.* Or “Transco could propose new firm rates that reflect a projected loss of IT volumes, and a projected increase for any additional firm service subscribed during the open season.” 104 FERC ¶ 61,171 P 48 (JA 400). What Transco could not do was “modify the existing shippers’ FT contracts to require that they take, and pay for, that capacity.” 107 FERC ¶ 61,156 P 51 (JA 494).

The challenged orders have addressed the Court's concern, and have offered Transco alternative ways to achieve its ends. Accordingly, the orders should be affirmed.

II. PETITIONERS' ARGUMENTS TO THE CONTRARY ARE UNAVAILING.

Petitioners make a number of arguments, trying to demonstrate that Transco proposes no more than a change in rate design permitted under the contracts' *Memphis* clauses, that the instant orders are inconsistent with the FTSL orders, or that any contract modification that may have occurred is justified by the public interest. All of these arguments are defeated by the salient attributes of Transco's proposal, discussed in the preceding section: the proposal would thrust upon FT-conversion shippers rights to supply-lateral capacity that could not be preempted; this forced transfer of rights would effectively preclude other shippers from purchasing the capacity, and would thereby assure a shift of all the laterals' fixed costs to the FT-conversion shippers; and the proposal would increase those shippers' rates to reflect this inevitable cost shift. Thus, the proposal would require the FT-conversion shippers to take primary point rights, which, in turn, would require modifications to the shippers' contracts beyond what is permitted in their *Memphis* clauses.

A. The FTW Proposal Would Impermissibly Modify Shipper Contracts.

Petitioners' first contention – that the FTW proposal is a mere change in rate design that is authorized by the contracts' *Memphis* clauses (Shippers' Br. at 11-19; Transco Br. at 16-19) – has already been rejected in *Exxon Mobil*. That case concluded that the FTW proposal constituted “an attempt to force supply lateral service on conversion shippers involuntarily under their existing FT contracts.” 315 F.3d at 310. Petitioners could “point to no case in which a *Memphis* clause [had] been used to force a customer to take additional service rather than to accept changes in the rates, terms, or conditions of service already agreed upon.” *Id.* The Court found it significant that Petitioners “had conceded that requiring customers to accept greater volumes of gas deliveries than called for in the their service contracts would not be authorized by a normal *Memphis* clause[,]” *id.*, clearly viewing such a requirement as analogous to the requirements Transco was trying to impose.

Nonetheless, Petitioners reiterate arguments that *Exxon Mobil* rejected. Petitioners try to explain away the fact that the FT-conversion shippers would be compelled to take a new service by arguing that the FTW proposal merely makes those shippers' pre-existing FT rights on the supply laterals explicit. Indicated Shippers contend that the IT-Feeder priority was established to assure FT-conversion shippers “the reliability and quality” of FT service, Shippers' Br. at 14, and effectively

extends those shippers’ “firm rights upstream into the supply laterals[.]” *Id.* at 15. Transco asserts the purpose and effect of the IT-Feeder priority was to give FT-conversion customers “*essentially firm* service on the upstream supply laterals[.]” Transco Br. at 16-18 (emphasis in brief). Petitioners made similar arguments in *Exxon Mobil*. See No. 01-1407, *et al.*, Initial Brief of Petitioners Exxon Mobil Corporation, *et al.*, at 20-24; Initial Brief of Petitioner Transcontinental Gas Pipe Line Corporation at 1.

These arguments were rejected in the first remand order “after an extensive review of the contracts and settlements” because ““the FT conversion customers’ firm contracts with Transco do not include service on the supply laterals.”” 107 FERC ¶ 61,156 P 24 (JA 489) (quoting 95 FERC at 62,134 (JA 255)). Indeed, “[t]he so-called ‘IT-feeder service’” was not a separate service at all, “but merely a higher priority” version of IT on the supply laterals. *Id.*

To be sure, the 1991 unbundling settlements provided the IT-Feeder priority “at least in part to give the FT-conversion shippers an opportunity to preserve the quality of their firm bundled sales services by ensuring the gas that they purchased would be given an essentially firm priority on the supply laterals.” 107 FERC ¶ 61,156 P 25 (JA 489) (citing 55 FERC at 62,345-46; 85 FERC at 62,384). However, *Exxon Mobil* pointed out that ““although the parties appear to have assumed during the negotiations

that FT conversion customers would contract separately with Transco for IT-feeder service, the settlement agreements did not actually require them to do so.” *Id.* (quoting 315 F.3d at 308). The FT-conversion shippers, in turn, chose *not* to contract for IT-Feeder service, but, instead, left it to producers and marketers to contract and to pay for this service when they ship the gas to the mainline. *Id.* Thus, the IT-Feeder priority “is received only by producers and marketers pursuant to their contracts with Transco[,]” and not by the FT-conversion shippers. *Id.*

A *Memphis* clause does not allow the pipeline to force a customer to take a service, redesigned or otherwise, that the customer is not taking. *See Exxon Mobil*, 315 F.3d at 310. Thus, the mere fact that the IT-Feeder priority is available to FT-conversion shippers does not permit Transco to require that they take a redesigned version of that service in the form of “primary service rights on the supply laterals in the production area[.]” 104 FERC ¶ 61,156 P 27 (JA 397).⁹

⁹ The foregoing also answers Transco’s contention that § 7.3 of its FT rate schedule, which limits use of the IT-Feeder priority (as defined in § 3.9 of its IT rate schedule) to the transportation of gas to the FT-conversion shippers’ mainline receipt points, somehow demonstrates that those shippers currently have the right “to access essentially firm service” on the supply laterals. *See Transco Br.* at 17-18. Transco’s tariff “does not require” FT-conversion shippers to purchase IT-Feeder service, and, indeed, makes that service “available to *all* shippers.” 107 FERC ¶ 61,156 P 26 (JA 489) (emphasis added). Moreover, the IT-Feeder priority is only available under § 3.9 of Transco’s IT rate schedule, not as part of its FT service. *Id.*

Petitioners' second rationale for their claim that the FTW proposal is permitted under the FT-conversion shippers' *Memphis* clauses attempts to explain away the fact that the proposal would compel those shippers to pay higher reservation rates. Shippers' Br. at 11-13; Transco Br. at 20. Petitioners point out that the shippers already pay reservation charges for the zones in which the supply laterals exist and that those reservation charges are derived from a pool of costs that include the supply laterals. Shippers' Br. at 11-12; Transco Br. at 20. As Petitioners see it, because the FTW proposal's elimination of the IT-Feeder priority would shift costs automatically to those reservation charges, the proposed rate increase would result from a change in rate design in zones for which FT-conversion shippers are already paying a reservation charge. *See* Shippers' Br. at 13.¹⁰

However, Transco's use of system-wide costs to derive production-area zone reservation rates "does not mean that shippers paying a zoned rate in one zone should be treated as also paying for other rate zones." 107 FERC ¶ 61,156 P 44 (JA 493). The Commission would deem a pipeline's unilateral proposal "to expand a shipper's primary contract path (*i.e.*, the portion of the mainline over which the shipper has

¹⁰ A similar argument was also made in *Exxon Mobil*, *see* No. 01-1407, *et al.*, Initial Brief of Exxon Mobil Corporation, *et al.*, at 15-19, but did not warrant discussion by the Court.

primary firm rights, commonly that portion of the mainline extending from the primary receipt point to the primary delivery point) into another rate zone . . . to be an unauthorized unilateral contract change under any *Memphis* clause.” *Id.* P 45 (JA 493).

Here, Transco effectively established a separate zone for the supply laterals “through its IT-feeder rate design[,]” 107 FERC ¶ 61,156 P 46 (JA 493), by exempting FT shippers on the production-area mainline from having to pay the laterals’ fixed costs. In designing its production-area rates, “Transco takes all the costs allocated to each zone and divides those costs by the contract demand represented by firm service and by the imputed contract demand represented by the interruptible service” – *i.e.*, the estimated interruptible volume. *Id.* Inclusion of the “additional imputed contract demand” for IT-Feeder service in the rate calculation reduces the reservation rate for FT in the production area zones. *Id.* Because it reduces the FT-conversion shippers’ reservation rates, this rate design has the same effect as would a rate design treating the supply laterals and the production-area mainline as separate rate zones. *Id.*

This *de facto* separation of zones is manifested by the Commission’s treatment of secondary point rights to the supply laterals. Unlike other FT shippers under Order No. 636, Transco’s FT-conversion shippers are not entitled to secondary point rights

on those laterals because, under the IT-Feeder rate design, the shippers are not responsible for the laterals' costs. 107 FERC ¶ 61,156 P 46 (JA 493) (citing 73 FERC ¶ 61,361 at 62,128 (1995)). Rather, Transco's tariff required, and continues to require, that these customers “enter into a separate contract and pay an additional amount in order to obtain [IT-Feeder] service” on the laterals. *Id.*

“Transco's FTW proposal would modify its production area rates in a way that would require the FT-conversion shippers to pay for primary firm service” not only on the production-area mainline but also on the supply laterals. 107 FERC ¶ 61,156 P 48 (JA 493). By “reserv[ing] all available firm capacity on the supply laterals for the FT-conversion shippers[,]” the proposal would “eliminate the IT-feeder volumes from its rate design volumes” and thereby force the FT-conversion shippers' to absorb the entire fixed costs of the supply laterals. *Id.* (JA 493-94). Indeed, “Transco explicitly acknowledges that this is the purpose of its filing.” *Id.* (JA 494).

If Transco were proposing “only to give FT-conversion customers normal secondary point rights arising from a change in rate design, it would have had primary firm capacity available for sale on the supply laterals, with the highest priority of service.” 107 FERC ¶ 61,156 P 49 (JA 494). *See also Process Gas*, 292 F.3d at 840 (pipelines have no obligation to give existing FT shippers a preference in competitive bidding for contested primary points). The sale of that capacity, in turn, “would have

then reduced the impact of the elimination of the IT-Feeder volumes on the existing rates charged to FT-conversion customers” by adding contract demand for FT. 107 FERC ¶ 61,156 P 49 (JA 494). Accordingly, by forcing FT-conversion customers to take primary point rights on the laterals, the FTW proposal had “the same practical effect as requiring the FT-conversion shippers to contract for primary firm service in an additional rate zone, which a *Memphis* clause does not authorize.” *Id.* P 50 (JA 494).

Indicated Shippers respond that this analysis is inconsistent with the “acknowledgment” in the second remand order that FT-conversion shippers pay reservation charges for zones that include supply laterals, Shippers’ Br. at 12 (citing 104 FERC ¶ 61,171 P 43 (JA 399)), and with FERC’s ruling in the FTSL orders that the IT-Feeder priority did not create a separate zone. *Id.* (citing 86 FERC at 61,609-11).

There is no inconsistency. FERC is simply stating that the FTW proposal would impose a requirement on the FT-conversion shippers that is *equivalent* to a requirement that those shippers take and pay for service in a new zone. Specifically, the proposal would require the shippers to take primary rights to capacity to which they previously lacked even secondary rights and increase the shippers’ reservation rates to reflect the inevitable cost shift that this forced transfer of rights would entail.

See 107 FERC ¶ 61,156 PP 41, 46, 48 (JA 492-94). FERC made clear that it did not deem the supply laterals a new zone by reaffirming that Transco’s elimination of the IT-Feeder priority would give FT-conversion shippers secondary rights on supply laterals, *see* 104 FERC ¶ 61,171 P 45 (JA 493), and by explaining that Transco would have to make a new filing “to establish the lateral capacity as a new zone[.]” 107FERC ¶ 61,156 P 51 (JA 494).¹¹

To support their contention that the FTW proposal merely redesigns rates for an existing service to FT-conversion shippers, Indicated Shippers also point to the FTSL orders’ statement that if Transco eliminated the IT-Feeder priority, FT-conversion shippers would be entitled to secondary point rights on the supply laterals. Shippers’ Br. at 16, 18. Therefore, Shippers assert, the FTW proposal simply preserves the FT-conversion shippers’ existing priority rights on the supply laterals, while shifting the costs of transportation to those shippers. *Id.* at 17.

¹¹ Indicated Shippers further assert that the “grandfathered” FT shippers, which have FT on both the laterals and mainline, pay the same reservation charge as the FT-conversion shippers. Shippers’ Br. at 12. Shippers did not raise this objection in the rehearing request to FERC. *See* JA 401-70. Shippers’ omission deprives the Court of jurisdiction to consider the objection on judicial review. *Panhandle E. Pipe Line Co. v. FPC*, 324 U.S. 635, 645 (1945); *ASARCO, Inc. v. FERC*, 777 F.2d 764, 773-74 (D.C. Cir. 1985).

Consistent with the FTSL orders, the challenged orders acknowledge that “the FTW proposal's elimination of the IT-Feeder service and corresponding changes in the rates for FT service would justify giving the FT-conversion shippers *secondary* firm point rights on the supply laterals[.]” 104 FERC ¶ 61,171 P 45 (JA 400) (emphasis in original). However, that proposal seeks “to impose on those customers *primary* firm rights[.]” *Id.* (emphasis in original). This Court recognized that the *Memphis* clauses in Transco’s transportation contracts did not authorize a forced transfer of primary rights. *Id.* See *Exxon Mobil*, 315 F.3d at 310. “[F]or that reason[.]” the FTW proposal is “an improper modification of the FT-conversion shippers’ contracts.” 104 FERC ¶ 61,171 P 45 (JA 400). See *id.* PP 42-47 (JA 399-400), discussed *supra* at 28-29.¹²

B. The FTW Proposal Would Force Mainline Shippers To Take Primary Point Rights on the Laterals.

Petitioners contend that the Commission incorrectly treated the FTW proposal as giving the FT-conversion shippers primary firm rights on the supply laterals and

¹² Indicated Shippers also assert that FERC’s rejection of the FTW proposal is inconsistent with the FTSL orders’ statement that “Transco had the contractual right to file for FTW rates.” Shippers’ Br. at 18 (citing 85 FERC at 62,389, 62,393). In fact, the instant orders make it clear that Transco can file for such rates as long as its proposal does not impermissibly modify its customers’ contracts. See, e.g., 107 FERC ¶ 61,156 P 51.

thus erroneously concluded that the proposal would improperly modify the shippers' contracts. Petitioners assert that the proposal does not provide primary rights because it does not propose any changes in the primary receipt points specified in the customers' contracts (Shippers' Br. at 20-21; Transco Br. at 13 & n.22), and provides those customers only *pro rata* rights to supply-lateral capacity. Shippers' Br. at 21-24. Indicated Shippers assert that such rights are secondary, rather than primary.

The Commission found otherwise. The FTW proposal was "properly treated as giving the FT-conversion shippers primary firm rights on the supply laterals" because those shippers would have "the highest possible priority on the supply laterals," and, therefore, Transco would be required "to reserve capacity on the supply laterals for them." 107 FERC ¶ 61,156 P 34 (JA 491). Because the "FTW proposal would require Transco to reserve capacity so as to give the FT-conversion shippers the highest priority on the supply laterals, subject only to certain grandfathered FT service[,]" *id.* P 35 (JA 491),¹³ the proposed lateral service met FERC's definition of FT service. *See id.* P 36 (JA 491) (quoting 18 C.F.R. § 284.7(a)(3)). "In contrast, secondary service . . . is secondary to the service held by the primary service

¹³ The Commission cited substantial record support for this contention. *See* FERC ¶ 61,156 P 35 (JA 491) (quoting testimony in FERC Docket No. RP93-136 at Tr. 1109-10; JA 441, 480).

holder[.]” available only “on an interruptible basis[.]” *Id.* (citing Order No. 636 at 30,429).

Order No. 636-A explained that “firm primary rights held by parties cannot be ‘bumped, preempted, or curtailed under the flexible receipt and delivery point policy.’” 107 FERC ¶ 61,156 P 37 (JA 491) (quoting Order No. 636-A at 30,583). In contrast, “if the FT-conversion shippers were using capacity on the supply laterals on a secondary basis, Transco could sell that lateral capacity to other shippers on a primary basis, and the FT-conversion shippers would then be subject to being bumped or preempted by the shippers with primary rights on the laterals.” *Id. See also Process Gas*, 292 F.3d at 840 (pipelines have no obligation to give existing FT shippers a preference in competitive bidding for contested primary points). Petitioners have conceded that Transco’s FTW proposal would not allow the FT-conversion shippers to be preempted in this manner. 107 FERC ¶ 61,156 P 37 (JA 491).

Under the FTW proposal, *pro rata* allocation would occur on the supply laterals only “when the FT-conversion shippers as a class seek to schedule more service on a particular supply lateral than that lateral can accommodate[.]” 107 FERC ¶ 61,156 P 39 (JA 491-92). In that situation, only FT-conversion shippers would receive allocations of capacity, and they “would not be bumped or preempted . . . in favor of a separate, higher priority primary firm service sold by Transco[.]” *Id.* (JA 492).

Petitioners contend that the fact that the FT-conversion shippers' rights to supply-lateral capacity could not be preempted demonstrates that the FTW proposal simply maintains the *status quo* because shippers using the IT-feeder priority also cannot currently be preempted. Shippers' Br. at 22; Transco Br. at 15-16. Petitioners' point appears to be that retention of the *status quo* does not constitute a modification of the FT-conversion shippers' contracts.

The fact that the FT-conversion shippers' supply-lateral priority would be the same as that of shippers currently taking IT-feeder service does not mean that the FTW proposal merely maintains the *status quo*. The FT-conversion shippers do not take IT-feeder service. 107 FERC ¶ 61,156 P 25 (JA 489). Transco cannot compel the shippers to take that service or a redesigned version of it without modifying their contracts beyond what is permitted under a *Memphis* clause. *See Exxon Mobil*, 315 F.3d at 310.¹⁴

There is another reason to conclude that Transco's FTW proposal forces FT-conversion shippers to take primary point rights. Treating the proposal as only giving

¹⁴ Indicated Shippers also claim that the FTSL Orders equated IT-feeder rights with secondary point rights. Shippers' Br. at 22 & n.96 (citing 86 FERC at 61,610). Shippers' failure to raise this objection on rehearing, *see* R. Item No. 3, deprives the Court of jurisdiction to consider it now. *Panhandle*, 324 U.S. at 645; *ASARCO*, 777 at 773-74.

those “shippers secondary point rights on the supply laterals, even though they would have to pay higher rates under the proposal” would be “inconsistent with Commission policy.” 107 FERC ¶ 61,156 P 41 (JA 492). That policy “treats secondary firm service as an adjunct to a primary firm service for which the shipper has already contracted and paid.” *Id.* The policy’s “linchpin” is the requirement “that the pipeline must give a firm shipper ‘flexibility in receipt and delivery points for the part of the system for which it pays a reservation charge.’” *Id.* (quoting Order No. 636-A at 30,585 and citing Order No. 636-B, 61 FERC at 62,013). Thus, a shipper’s payment of a reservation charge for primary point rights on a particular segment of the system by itself entitles that shipper to secondary point rights throughout the zone in which that segment exists. Here, Transco’s “FT-conversion shippers have only contracted for primary firm service on the production area mainline,” and “their reservation charges do not include responsibility for the supply laterals.” *Id.* P 42 (JA 492).

The FTW proposal would provide the FT-conversion shippers rights to supply-lateral capacity, but unlike the situation where secondary point rights are conferred, the shippers would have to pay an increased reservation charge for these rights. The proposal would replace the current recovery of Transco’s fixed supply-lateral costs “via IT Feeder rates paid by producers and marketers” with recovery of the costs “via FT reservation rates paid by FT shippers.” 107 FERC ¶ 61,156 P 42 (JA 492).

(quoting JA 416 (Transco's rehearing request)). Indeed, "the entire purpose of Transco's FTW proposal is to require the FT-conversion shippers to take and to pay for primary rights on the supply laterals for which they are not currently paying, not to give them secondary firm rights on facilities for which they are already paying." *Id.*

It follows that the "proposal goes beyond simply giving the FT-conversion shippers rights that are a derivative of their current primary firm service on the production area mainline." 107 FERC ¶ 61,156 P 42 (JA 492). Thus, this proposed change "cannot be implemented through a modification" in Transco's "existing terms and conditions of service[,]" *id.*, but must be effectuated through a modification of the FT-conversion shippers' contracts.

In short, Indicated Shippers' claim that the FTW proposal gives FT-conversion shippers mere secondary rights to supply-lateral capacity is incorrect. The proposal would force the FT-conversion shippers to take rights to supply-lateral capacity that cannot be preempted by later FT purchasers, and to pay increased reservation charges for Transco's reservation of that capacity. The rights conferred are thus primary, not secondary.

C. Approval of the FTW Proposal Is not in the Public Interest.

Alternatively, Shippers argue that the public interest mandates FERC using its authority under NGA § 5(a) to effectuate any contract modification that the FTW

proposal would entail. Shippers' Br. at 24-29. Shippers contend that FERC has not reconciled (1) Order No. 636's conclusion that the public interest requires the abrogation of contracts that use non-SFV rate designs with (2) the challenged orders' refusal to eliminate Transco's exclusive use of non-SFV rates on its supply laterals. *Id.* at 25-26. Shippers contend that having to charge IT-Feeder rates on the supply laterals puts Transco at a competitive disadvantage and, thus, creates the very type of competitive distortion Order No. 636 sought to prevent. *Id.* at 26.

Indicated Shippers have failed to satisfy "their burden to show that the public interest requires the Commission to take such an extraordinary step as to require customers to take and pay for a service for which they have not contracted." 107 FERC ¶ 61,156 P 55 (JA 495). Transco's FTW proposal went well "beyond a simple change in rate design comparable to the change from MFV to SFV" that Order No. 636 directed. *Id.* P 57 (JA 495). Rate design "refers to the method of designing the unit rates to be paid by customers of each class" and "occurs only after costs are allocated to each zone and class of customers." *Id.* (citing Order No. 636 at 30,431).

Order No. 636 required a change from MFV to SFV rate design so that pipelines would recover a greater share of the costs already allocated to FT shippers through reservation charges and a smaller share of those costs through volumetric charges; in contrast, Transco's FTW proposal "reallocates costs from IT services to

the FT-conversion customers, so that all firm customers will pay more.” 107 FERC ¶ 61,156 P 57 (JA 495-96) (citing JA 416 (Transco’s rehearing request)). Accordingly, Transco’s proposal is “not a rate design change . . . but an effort to reallocate costs from one set of shippers to the FT customers by requiring FT customers to take primary firm service on the laterals.” *Id.* (JA 496). In addition, Indicated Shippers have “provided no evidence to show that any other substantial harm will result if the proposed FTW rates are not accepted, such that an entity will go out of business, consumers will be excessively burdened, or there will be undue discrimination as is required to meet the *Mobile-Sierra* public interest standard.” *Id.* P 58 (JA 496) (citing *Northeast Utils. Serv. Co. v. FERC*, 55 F.3d 686, 692-93 (D.C. Cir. 1995)).¹⁵

In any event, the Commission identified ways that Transco could implement an SFV rate design for FT on its supply laterals without reallocating costs currently paid by IT shippers onto FT-conversion shippers. *See, e.g.*, 107 FERC ¶ 61,156 P 51 (JA 494). Thus, Indicated Shippers’ attempt to justify Transco’s unjust and unreasonable

¹⁵ Moreover, the Commission’s “SFV regulation has always permitted departures from SFV in individual cases[.]” 107 FERC ¶ 61,156 P 56 (citing 18 C.F.R. § 284.7(e)), and since the issuance of Order No. 636 “the circumstances of the natural gas industry have changed[.]” *Id.* (citing *Tennessee Gas Pipeline Co.*, 77 FERC ¶ 61,083, at 61,355-359 (1996), *order on reh’g*, 78 FERC ¶ 61,069 (1997)).

rate proposal as serving the goals of Order No. 636 and, therefore, the public interest cannot be supported.

CONCLUSION

For the foregoing reasons, the Commission requests that the orders under review be affirmed in their entirety.

Respectfully submitted,

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June 3, 2005

NO ORAL ARGUMENT YET SCHEDULED

**IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT**

No. 04-1226, *et al.*

**EXXON MOBIL CORPORATION, *et al.*
PETITIONERS,**

v.

**FEDERAL ENERGY REGULATORY COMMISSION,
RESPONDENT.**

**ON PETITION FOR REVIEW OF ORDERS OF THE
FEDERAL ENERGY REGULATORY COMMISSION**

**BRIEF OF RESPONDENT
FEDERAL ENERGY REGULATORY COMMISSION**

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**FOR RESPONDENT
FEDERAL ENERGY REGULATORY
COMMISSION
WASHINGTON, DC 20426**

JUNE 3, 2005

CIRCUIT RULE 28(a)(1) CERTIFICATE

- A. Parties and Amici:** All participants in the proceedings below and in this Court are listed in Petitioners' Circuit Rule 28(a)(1) certificate.
- B. Rulings Under Review:**
1. *Transcontinental Gas Pipe Line Corp.*, Docket No. RP92-137, 104 FERC ¶ 61,171 (2003) (JA 392-400).
 2. *Transcontinental Gas Pipe Line Corp.*, Docket No. RP92-137, 107 FERC ¶ 61,156 (2004) (JA 485-96).
- C. Related Cases:** Counsel is not aware of any related cases pending before this or any other Court.

Dennis Lane
Solicitor

June 3, 2005